ORIGINAL

0000100227

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RULEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. E-01345A-08-0172 **STAFF'S NOTICE OF FILING DIRECT TESTIMONY IN SUPPORT OF PROPOSED SETTLEMENT AGREEMENT**

Staff of the Arizona Corporation Commission ("Staff") hereby provides notice of filing its Direct Testimony in Support of Proposed Settlement Agreement in this Docket. An original and thirteen copies are submitted of the Prefiled Direct Testimony of Ernest G. Johnson, Barbara Keene, Ralph C. Smith and Frank Radigan.

RESPECTFULLY SUBMITTED this 1st day of July, 2009.

Janet Wagner, Assistant Chief Counsel
Maureen A. Scott, Senior Staff Counsel
Amanda Ho, Attorney
Charles Hains, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Arizona Corporation Commission
DOCKETED
JUL -1 2009
DOCKETED BY

Original and thirteen (13) copies of the foregoing were filed this 1st day of July, 2009 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85008

Copies of the foregoing mailed this
1st day of July, 2009 to:

Thomas L. Mumaw
Meghan H. Grabel
PINNACLE WEST CAPITAL CORPORATION
LAW DEPARTMENT
P.O. Box 53999
Phoenix, Arizona 85072-3999

William J. Maledon
OSBORN MALEDON P.A.
2929 North Central Avenue
Phoenix, Arizona 85067-6379

Robert Metli
SNELL & WILMER L.L.P.
400 East Van Buren Street
Phoenix, Arizona 85004-2202

Barbara Klemstine
Zachary Fryer
Susan Casady
ARIZONA PUBLIC SERVICE COMPANY
P.O. Box 53999
Mail Station 9708
Phoenix, Arizona 85072-3999

Michael L. Kurtz
Kurt J. Boehm
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202

C. Webb Crockett
Patrick J. Black
FENNEMORE CRAIG P.C.
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913

Lawrence V. Robertson, Jr.
Attorney at Law
P.O. Box 1448
Tubac, Arizona 85646

Michael A. Curtis
William P. Sullivan
Larry K. Udall
CURTIS, GOODWIN, SULLIVAN,
UDALL & SCHWAB, P.L.C.
501 East Thomas Road
Phoenix, Arizona 85012-3205

Kevin Higgins
ENERGY STRATEGIES, LLC
215 South State Street, Suite 200
Salt Lake City, Utah 84111

Timothy M. Hogan
ARIZONA CENTER FOR LAW IN
THE PUBLIC INTEREST
202 East McDowell Road, Suite 153
Phoenix, Arizona 85004

Daniel W. Pozefsky
Residential Utility Consumer Office
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007

Michael M. Grant
GALLAGHER & KENNEDY
2575 East Camelback Road
Phoenix, Arizona 85016-9225

Gary Yaquinto
ARIZONA INVESTMENT COUNCIL
2100 North Central Avenue, Suite 210
Phoenix, Arizona 85004

Jay I. Moyes
MOYES SELLERS & SIMS
1850 North Central Avenue, Suite 1100
Phoenix, Arizona 85004-0001

David Berry
WESTERN RESOURCE ADVOCATES
P.O. Box 1064
Scottsdale, Arizona 85252

Jeff Schlegel
SWEEP Arizona Representative
1167 West Samalayuca Drive
Tucson, Arizona 85704

Jeffrey J. Woner
K.R. SALINE & ASSOC., PLC
160 North Pasadena, Suite 101
Mesa, Arizona 85201

Scott Canty, General Counsel
THE HOPI TRIBE
P.O. Box 123
Kykotsmovi, Arizona 86039

Cynthia Zwick
1940 East Luke Avenue
Phoenix, Arizona 85016

Nicholas J. Enoch
Lubin & Enoch, P.C.
349 North 4th Avenue
Phoenix, Arizona 85003

Carlo Dal Monte
65 Front Street, Suite 201
Nanaimo, British Columbia V9R 5H9
Canada

Barbara Wyllie-Pecora
27458 N. 128th Dr.
Peoria, Arizona 85383

Amanda Ormond
7650 S. McClintock
Suite 103-282
Tempe, Arizona 85284

Douglas Fant
3655 W. Anthem Way
SuiteA-109 PMB 411
Anthem, Arizona 85086

Lieutenant Colonel Karen White
AFLSA/JACL-ULT
139 Barnes Dr., Suite 1
Tyndall AFB, Florida 32403-5319

Steve Morrison
SCA Tissue North America
14005 West Old Highway 66
Bellemont, Arizona 86015

Karen Christine

DIRECT
TESTIMONY
OF

ERNEST G. JOHNSON

BARBARA KEENE

RALPH C. SMITH

FRANK RADIGAN

DOCKET NO. E-01345A-08-0172

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANYFOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RULEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN

JULY 01, 2009

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	DOCKET NO. E-01345A-08-0172

DIRECT TESTIMONY

SUPPORTING THE SETTLEMENT AGREEMENT

OF

ERNEST G. JOHNSON

DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 1, 2009

TABLE OF CONTENTS

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172

Mr. Johnson provides policy level testimony in support of the Settlement Agreement ("Agreement"). Mr. Johnson's testimony summarizes the settlement process, provides reasons which support Staff's conclusions that the Agreement is in the public interest, and addresses several general policy considerations underlying the provisions in the Agreement.

The Agreement's provisions are broken down into the following broad substantive categories:

II) Rate Case Stability Provisions
III) Rate Increase
IV) Cost of Capital
V) Depreciation
VI) Fuel and Power Supply Adjustment Provisions
VII) APS Expense Reduction Commitment
VIII) Equity Infusions to be Made by APS
IX) Pension and OPEB Deferrals
X) Treatment of Schedule 3
XI) Adjustment of Depreciation Rates for Palo Verde License Extension
XII) Limit on Recovery of Annual Cash Incentive Compensation for APS Executives
XIII) Periodic Evaluation
XIV) Demand Side Management
XV) Renewable Energy
XVI) Low Income Programs
XVII) Revenue Spread
XVIII) Rate Design
XIX) Interruptible Rate Schedules and Other Demand Reduction Programs
XX) Demand Response
XXI) Other

In addition to Mr. Johnson's testimony highlighting policy considerations underlying the Agreement's provisions, Staff will be presenting three other witnesses who will also be providing testimony in support of the Agreement. Mr. Ralph Smith will address the Agreement from an accounting and revenue requirements perspective. More specifically, his testimony will focus on Sections III, IV, V, VI, VIII, IX, X and XI of the Agreement. Ms. Barbara Keene will address Schedule 3, Renewable Energy, Demand-side Management, and the PSA Plan of Administration. Her testimony covers Sections VI, X, XIV, and XV of the Agreement. Finally, Mr. Frank Radigan will address the rate design provisions contained in the Agreement, including inclining Block Rate, Time of Use Rates and other rate design changes or other rate schedule matters. His testimony covers Sections XVII and XVIII of the Agreement.

The agreed upon provisions in each of these areas were the result of many hours of negotiation and a lot of give and take on the part of all of the parties. The settlement process was open, transparent and inclusive. In the end, while the total rate increase reflected in the Agreement was higher than what Staff had recommended in its Direct Testimony, the increase and other revenue requirement provisions are designed to improve the Company's financial metrics and bond ratings which the Signatories believe will ultimately benefit not only APS but also its customers by allowing the Company to borrow at more attractive rates, and by improving its credit worthiness which should improve its operational flexibility. The provisions are also designed to ensure more predictability and stability in rate case filings by APS over the next few years. In addition, I believe that the Agreement puts the Company on the right path with respect to Arizona's energy future. The Agreement contains a myriad of important commitments by the Company to invest in and make available various renewable energy and demand-side management programs. The Agreement also contains new rate design options designed to move load to off peak hours.

The Agreement also establishes performance measurements that APS must meet in order to recover the costs of increases to executive cash incentive compensation beyond test year levels. The Agreement also contains important reporting requirements and makes provision for a Benchmarking Study whereby APS' performance in a number of areas will be compared to a peer group of companies with similar characteristics.

Finally, the Agreement is in the public interest because of all of the important benefits to customers which I highlight below:

<u>Investment in Arizona's Energy Future.</u>

- Establishment of energy efficiency goals and the creation of tiered performance incentives to encourage meeting those goals;
- At least 100 schools served by DSM programs and at least 1,000 customers in existing homes served by the Home Performance enhanced program element by December 31, 2010;
- Placement of renewable energy projects at Arizona schools and government institutions;
- A plan for utility scale photovoltaic generation and an RFP for in-state wind generation;
- Additional renewable energy projects to be in place by 2015 which, in combination with existing renewable commitments, will result in approximately 10% of APS' retail sales coming from renewable resources; and,
- Construction of one or more renewable energy transmission facilities.

<u>Commitments Benefiting Low-Income Customers.</u>

- Continued rate discounts for low income ratepayers, holding these ratepayers harmless from the rate increase;

- Creation of a new bill assistance program to benefit customers whose incomes exceed 150% of the Federal Poverty Income Guidelines but are less than or equal to 200% of the Federal Poverty Income Guidelines, funded by APS; and,
- Waiving additional security deposits for low income ratepayers.

Rate Stability Plan.

- An increase in rate stability, including an extended period without base rate increases and a scheduled plan for future rate cases, resulting in greater administrative efficiency and reduced uncertainty for both APS and ratepayers.

Rate Related Benefits.

- An improvement in APS' ability to attract capital, maintain reliability and sustain growth;
- A limit on recovery through rates in certain circumstances of executive incentive compensation based upon performance;
- A sustained reduction of expenses of at least an average of $30 million per year over the Plan Term, which will reduce the need for future rate increases;
- An infusion of at least $700 million of additional equity strengthen APS' bond rating and reduce its future debt costs;
- A plan to be prepared by APS to maintain investment grade financial ratios and improve APS' financial metrics;
- An acceleration of the refund of any potential over-collected amounts in the PSA account, resulting in a lower adjustor rate that would partially offset the base rate increase;
- A reduced Systems Benefits Charge in 2012 if a Palo Verde license extension is approved before the conclusion of the next rate case; and,
- Continued 90/10 sharing of the PSA.

Creation of Performance Measures for APS.

New Rate Design Options.

- Creation of an optional super-peak tariff for residential customers and other critical peak pricing rates;
- Twelve month reopening of the E-20 House of Worship tariff;
- Development of Interruptible Rate Schedules and other Demand Response Programs for large customers; and,
- A new optional time of use rate for schools.

The total rate increase reflected in the Agreement is $344,738,000. This includes a Base Rate Increase of approximately $131.1 million over the interim rate increase of $65.2 million, or a total Base Rate Increase of $196.3 million. The percentage Base Rate Increase, including both the interim increase and the $11.2 million of revenue associated with establishing new base fuel levels represents a 7.9% increase in base rate revenue. The total rate increase reflected in the Agreement also includes an increase in base fuel costs of $137.2 million. The total rate increase, including both the Base Rate Increase and the increase in base fuel costs, represents a 13.07% increase in rates. In addition to the Base Rate Increase, various of the Agreement's provisions relating to fuel and purchased power costs, renewable energy, and energy efficiency may have the impact of increasing or decreasing the amounts collected from customers under the Company's various adjustor mechanisms.

The bill impact analysis filed by the Signatories indicates that for a typical residential customer, with average monthly consumption of 1,408 kWh during summer months and 930 kWh for winter months, the increase would be $8.98 per month in the summer and $3.67 per month in the winter or an annual average of $6.332 per month. Estimates of the 2010 DSM Adjustment Clause and the 2010 RES were included in the bill impact analysis for illustrative purposes, but those adjustments will not be implemented at the same time as base rate increases.

My overall recommendation to the Commission is to approve the Agreement because it strikes an appropriate balance between APS' ratepayers and its shareholders, and is in the public interest.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Ernest G. Johnson, 1200 West Washington Street, Phoenix, Arizona 85007.

Q. By whom are you employed and in what capacity?

A. I am employed by the Arizona Corporation Commission ("ACC" or "Commission") as the Director of the Utilities Division.

Q. Briefly describe your responsibilities as Utilities Director.

A. I am responsible for the day-to-day operations of the Utilities Division, including policy development, case strategy, and overall Division management.

Q. Please summarize your educational background and professional experience.

A. In 1979 and 1982, respectively, I earned Bachelor of Science and Juris Doctorate degrees, both from the University of Oklahoma. I have been involved in the regulation of public utilities since 1986. I was employed by the Oklahoma Corporation Commission in 1986 in various legal capacities. In 1993, I was named acting Director and served in that position until mid-1994. I served as permanent Director from mid-1994 until October 2001. In October of 2001, I assumed my current position with the Arizona Corporation Commission. While serving in these capacities, I have participated in numerous regulatory proceedings, including providing policy analysis concerning Electric Restructuring before the Oklahoma Corporation Commission, the Oklahoma State Legislature, and the Arizona Commission.

Q. Did you participate in the negotiations that led to the execution of the Proposed Agreement?

A. Yes, I did.

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to support the Settlement Agreement ("Agreement").

Q. How is your testimony being presented?

A. My testimony is organized into four sections. Section I provides discussion and insight into the Settlement process. Section II identifies and discusses the reasons why the Settlement Agreement ("Agreement") is in the public interest. Section III addresses several general policy considerations. Section IV is responsive to Commissioners letters filed in the docket.

Q. Who else is providing Staff testimony, and what issues will they address?

A. Staff will present the following witnesses:

Staff's Consultant Ralph Smith will be covering in more detail the technical areas of revenue deficiency, accounting, and depreciation rates as well as the following sections of the Settlement Agreement:

III. Rate Increase
IV. Cost of Capital
V. Depreciation
VI. Fuel and Power Supply Adjustment provisions
VIII. Equity Infusions
IX. Pension and OPEB Defferals
X. Treatment of Schedule 3
XI. Adjustment of Depreciation rates for Palo Verde License extension

Staff Witness Barbara Keene will be covering in more detail the Settlement Sections that pertain directly to the following:

- System Facility Charge.
- Impact fee.
- Revisions to Schedule 3.
- Renewable Energy.
- Demand-Side Management.
- PSA Plan of Administration.

Staff Witness Frank Radigan will be covering in more detail the Settlement Sections that pertain to the following:

Rate Design including:

- Inclining Block Rate.
- Time of Use.
- Interruptible Rate Schedules and other Demand Reduction Programs.
- Demand Response.
- Other Rate Design Changes.
- Other rate schedule matters.

SECTION I – SETTLEMENT PROCESS

Q. Please discuss the Settlement process.

A. The Settlement process was open, transparent, and inclusive. All parties received notice of the Settlement meetings and were accorded an opportunity to raise, discuss, and propose resolution to any issues that they desired.

Q. How many Settlement meetings were held?

A. There were approximately 21 meetings held on the following dates: January 30, 2009, February 5, 2009, February 10, 2009, February 13, 2009, February 18, 2009, February 25, 2009, March 2, 2009, march 10, 2009, March 16, 2009, March 25, 2009, April 6, 2009, April 21, 2009, April 24, 2009, May 1, 2009, May 7, 2009, May 21, 2009, June 1, 2009, June 4, 2009, June 8, 2009, June 10, 2009 and June 11, 2009.

Q. Who participated in those meetings?

A. The following parties were participants in all or some of the Settlement meetings: Arizona Public Service Company ("APS"), AzAg Group, Arizona Association of School Business Officials ("AASBO"), Arizona Investment Council ("AIC"), Arizona School Boards Association ("ASBA"), Arizonans for Electric Choice and Competition ("AECC"), Bowie Power Station, LLC ("Bowie"), Cynthia Zwick, Federal Executive Agencies ("FEA"), Freeport-McMoRan Copper & Gold Inc. ("Freeport-McMoRan"), IBEW Locals 387, 640, 769, Interwest Energy Alliance ("Interwest"), Kroger Co. ("Kroger"), Mesquite Power, LLC ("Mesquite"), Residential Utility Consumer Office ("RUCO"), Southwest Energy Efficiency Project ("SWEEP"), Southwestern Power Group II, LLC ("SWPG"), Town of Wickenburg, Western Resource Advocates ("WRA") and the Arizona Corporation Commission Utilities Division ("Staff").

Q. Could you identify some of the diverse interests that were involved in this process?

A. Yes. The participants represented very diverse interests and included Staff, RUCO, APS, a shareholder association, consumer representatives, merchant plants, large customers of APS, federal agencies, demand side management ("DSM") advocates, low-income customer advocates, and renewable energy advocates, just to name a few.

Q. How many of these parties executed the stipulation?

A. Approximately 20 parties executed the Agreement.

Q. Were there other parties who were not Signatories to the Agreement?

A. Yes, one intervenor, Barbara Wyllie-Pecora, who had specific concerns about APS' line extension tariff, is not a Signatory to the Agreement.

Q. Did Staff and the Signatories to the Agreement meet with all the interested parties in Docket?

A. Yes. Staff and other Signatories met with the Wyllies on March 16, 2009, to discuss the issue on line extension (Schedule 3). Also, on May 15, 2009, Commission Staff met with Mike Wyllie to discuss the Schedule 3 issue and assist them in understanding the Commission process to include but not limited to open record request.

Q. In your opinion, was there an opportunity for all issues to be discussed and considered?

A. Yes. In my opinion, each party had the opportunity to raise and have their issues considered.

Q. Were the Signatories able to resolve all issues?

A. Yes, the Signatories were able to resolve and reach agreement on all issues.

Q. How would you describe the negotiations?

A. I believe that all participants zealously advocated and represented the interests of their constituents. I would characterize the discussions as candid but professional. I am extremely pleased with the desire and effort put forth by all parties. I must note that all parties had the opportunity to be heard and to have their issues fairly considered.

Q. Mr. Johnson, would you describe the process as requiring a lot of give and take?

A. Yes, I would. As a result of the many and varied interests represented in the Settlement process, a willingness to compromise was absolutely necessary. As evidenced in the Agreement, the Signatories compromised vastly different litigation positions.

Q. In your previous response, you stated that the parties were able to settle despite vastly different litigation positions. Is that correct?

A. Yes.

Q. In your opinion, was the public interest unduly compromised?

A. No, not in my opinion. As I will discuss later in this testimony, I believe that the compromises made by the various parties will actually further the public interest.

Q. Mr. Johnson, you have indicated that the Settlement Proposal incorporates many diverse interests, including those of low-income customers, residential, commercial, industrial customers, merchant generators, and retail energy marketers. Please indicate how the Agreement takes these into account.

A. Within the Agreement, there are specific provisions which address many of the concerns expressed by the above-referenced interests. Examples include, Section XIV to include Energy Efficiency (DSM), Section XV Renewable Energy, Section XVI Low-Income, Section XIX Interruptable Rates, and Section XX Demand Response.

Q. Mr. Johnson, are there any other comments you would like to make in regard to the Settlement process?

A. Yes. In my view, the Settlement process resulted in an Agreement which some may not view as perfect but nonetheless is balanced and consistent with the public interest.

SECTION II – PUBLIC INTEREST

Q. Mr. Johnson, in Staff's opinion, is the Proposed Settlement in the public interest?

A. Yes absolutely. In Staff's opinion, the Proposed Settlement is fair, balanced, and in the public interest.

Q. Mr. Johnson, would you briefly summarize the reasons that Staff concludes that the Settlement is fair, balanced, and in the public interest.

A. The agreed upon provisions in each of these areas were the result of many hours of negotiation and a lot of give and take on the part of all of the parties. The settlement process was open, transparent and inclusive. In the end, while the total rate increase reflected in the Agreement was higher than what Staff had recommended in its Direct Testimony, the increase and other revenue requirement provisions are designed to improve the Company's financial metrics and bond ratings which the Signatories believe will ultimately benefit not only APS but also its customers by allowing the Company to borrow at more attractive rates, and by improving its credit worthiness which should improve its operational flexibility. The provisions are also designed to ensure more predictability and stability in rate case filings by APS over the next few years. In addition, I believe that the Agreement puts the Company on the right path with respect to Arizona's energy future. The Agreement contains a myriad of important commitments by the Company to invest in and make available various renewable energy and demand-side management programs. The Agreement also contains new rate design options designed to move load to off peak hours.

The Agreement also establishes performance measurements that APS must meet in order to recover the costs of increases to executive cash incentive compensation beyond test year levels. The Agreement also contains important reporting requirements and makes provision for a Benchmarking Study whereby APS' performance in a number of areas will be compared to a peer group of companies with similar characteristics.

The Agreement also provides many benefits for customers including:

a) Investments in Arizona's Energy Future.

- Establishment of energy efficiency goals and the creation of tiered performance incentives to encourage meeting those goals;
- At least 100 schools served by DSM programs and at least 1,000 customers in existing homes served by the Home Performance enhanced program element by December 31, 2010;
- Placement of renewable energy projects at Arizona schools and government institutions;
- A plan for utility scale photovoltaic generation and an RFP for in-state wind generation;
- Additional renewable energy projects to be in place by 2015 which, in combination with existing renewable commitments, will result in approximately 10% of APS' retail sales coming from renewable resources; and,
- Construction of one or more renewable energy transmission facilities.

b) Commitments Benefiting Low-Income Customers.

- Continued rate discounts for low-income ratepayers, holding these ratepayers harmless from the rate increase;
- Creation of a new bill assistance program to benefit customers whose incomes exceed 150% of the Federal Poverty Income Guidelines but are less than or equal to 200% of the Federal Poverty Income Guidelines, funded by APS; and,
- Waiving additional security deposits for low-income ratepayers.

c) Rate Stability Plan.

- An increase in rate stability, including an extended period without base rate increases and a scheduled plan for future rate cases, resulting in greater administrative efficiency and reduced uncertainty for both APS and ratepayers.

d) Rate Related Benefits.

- An improvement in APS' ability to attract capital, maintain reliability and sustain growth;
- A limit on recovery through rates in certain circumstances of executive incentive compensation based upon performance;
- A sustained reduction of expenses of at least $30 million per year, which will reduce the need for future rate increases;
- An infusion of at least $700 million of additional equity and an improvement in APS' financial metrics, strengthening its bond rating and reducing future debt costs;
- A plan to be prepared by APS to maintain investment grade financial ratios and improve APS' financial metrics;
- A potential acceleration of the refund of any over-collected amounts in the PSA account, resulting in a lower adjustor rate that would partially offset the base rate increase;
- A reduced Systems Benefits Charge in 2012 if a Palo Verde license extension is approved before the conclusion of the next rate case; and,
- Continuation of the 90/10 sharing provisions in the PSA.

e) Creation of Performance Measures for APS.

f) New Rate Design Options.

- Creation of an optional super-peak tariff for residential customers and other critical peak pricing rates;
- Twelve month reopening of the E-20 House of Worship tariff;
- Development of Interruptible Rate Schedules and other Demand Response Programs for large customers; and,
- A new optional time of use rate for schools.

Q. Are there other reasons why Staff believes the Agreement promotes the public interest?

A. Yes, additional benefits of the Settlement Agreement include:

- No base rate increase to low-income customers.
- Limits the base rate revenue increase to approximately 7.9 percent.
- Implements a demand-side management and performance incentive.
- Provides for expanded time-of-use options to customers.

Q. Mr. Johnson, do you believe that the Settlement results in just and reasonable rates for consumers. Please explain.

A. Yes. In its 2008 Rate Application, APS proposed a rate increase in the amount of $488 million. Staff recommended a rate increase of $307 million. In the proposed Agreement, the Signatories recommend approximately $345 million which represents an increase that is $143 million less than the Company requested. While the amount represents an approximately $38 million increase over Staff's Direct Testimony, the Agreement contains many provisions designed to benefit consumers which I have already discussed.

It is also important to take note of the extraordinary financial times facing APS, its customers, and others. As the Agreement points out, in the fall of 2008, pre-existing difficulties in the subprime mortgage market escalated, resulting in one of the most severe financial crises in the debt and equity markets this country has seen. That crisis underscored the importance for companies like APS to maintain financial metrics in order to (i) allow access to the volatile and uncertain financial markets to secure necessary financing at reasonable rates, and (ii) allow APS to obtain credit from vendors and lenders on reasonable terms. That financial crisis continues today. As part of that crisis, Arizona and the rest of the nation have also entered into a severe recession which is negatively impacting APS, its customers and other interested parties.

Q. Mr. Johnson, with the background you just shared, is it your view that the revenue requirement set forth in the Agreement results in appropriate utility revenue and just and reasonable rates for consumers?

A. Yes, that is my opinion. Staff believes that the Agreement is fair to ratepayers because it results in just and reasonable rates for consumers. Staff believes that it is fair to the utility because it provides revenues necessary for the utility to provide reliable electric service along with an opportunity for a reasonable profit. Staff believes that this proposal balances many diverse interests, including those of low-income, residential, commercial, and industrial customers, merchant generators, retail energy marketers, and other stakeholders. Staff believes that the Agreement promotes the public interest by facilitating the provision of reliable electric service at reasonable rates.

Q. Please discuss how the Settlement is fair to the utility.

A. As noted in the Agreement, the settling parties included an additional revenue requirement amount related to recognizing post test year plant through June 30, 2009. In addition, illustratively, the Settlement would provide APS with revenues which would allow it an opportunity to earn an overall rate of return of approximately 6.65 percent on fair value rate base of $7.666 billion[1], and an 11 percent return on equity[2]. Also, Staff made a higher adjustment to the fair value rate of return. Staff believes that the Agreement is fair to the utility because it provides an opportunity for APS to earn revenues sufficient for the utility to provide reliable electric service and to achieve a reasonable profit.

As noted by the Agreement, the Signatories believe that the Agreement creates a rate and financial stability program for APS that appropriately balances the risks of APS, its employees, its customers, and other interested parties. The Agreement creates a frame work that could ultimately improve APS' financial metrics and bond ratings which over the long term would also benefit customers by allowing APS to borrow at more attractive rates and also improve its vendor lender credit worthiness thereby creating financial flexibility. The Signatories also believe that the Agreement results in just and reasonable rates for APS and its customers and avoids unnecessary litigation and delay.

---

[1] See, e.g., Settlement Agreement paragraphs 3.5 and 4.3.
[2] See, e.g., Settlement Agreement paragraph 4.2.

Q. Mr. Johnson, please explain how Staff and the other Signatories came up with the $196.3 million Base Rate Increase?

A. Yes. The $196.3 million was arrived at through the process of vigorous negotiation among the Signatories. Among other things, as stated on page 12, Section 3.4 of the Agreement, the $196.3 million Base Rate Increase incorporates, in addition to other items contained in Staff's Direct Case, a return on and of post test year plant through June 30, 2009, 18 months beyond the test year ending December 31, 2007. As also noted in the Agreement Paragraph 3.4, the Signatories desired to enhance APS' ability to retain and improve its current investment grade credit rating, thereby enabling the Company to attract capital at reasonable cost and to also optimize its operational flexibility.

Q. Mr. Johnson, for ratemaking purposes, is Arizona a future test year state?

A. No. As stated in my Direct Testimony, specifically on pages 4 lines 13 - 15, "This jurisdiction has traditionally utilized an adjusted historical test period in contrast to a forecasted, future or partially projected test year period."

Q. Mr. Johnson, can you please explain why Staff recommended the inclusion of post test year plant in determining the Revenue Requirement?

A. Yes, I will discuss the detail in the policy recommendation section of my testimony.

Q. Please discuss how the 11 percent Return on Equity proposed in the Agreement was derived?

A. As previously stated, the Settlement provides for a Fair Value Rate of Return of 6.65 percent on Fair Value Rate Base and would allow APS the opportunity to earn an 11.0 percent return on equity[3]. In Staff's opinion, it is necessary given the current economic

[3] See, e.g., Settlement Agreement paragraphs 3.5, 4.2 and 4.3.

downturn for APS to have sufficient revenues and reasonable access to capital, which will allow it to properly maintain its system and provide reliable electrical service.

Q. How did the current financial circumstances and APS' need to have reasonable access to capital affect the Agreement reached in this case?

A. There has been much discussion in the APS current base rate case, its prior rate case and in APS' requests for emergency rate relief and/or interim rates about APS' bond rating and the impact that a downgrade to a below-investment-grade rating would have on APS' financing costs. APS' bond rating has been and currently is investment grade; however, concerns have been raised because it is at the lowest level of investment grade under at least one of the three major bond rating agencies rankings. The Signatories to the Agreement believe that it is in the best interests of APS, and APS' ratepayers for the Company to maintain and preferably improve upon its current investment grade bond rating, as this will help facilitate APS' access to the capital markets and will help minimize the amount of future financing costs borne by ratepayers. At one point, the Company suggested that the cost to ratepayers of a non-investment grade rating could be as much as $1 billion over 10 years. [4]

The Settlement Agreement includes several provisions that are intended to help support APS' access to financing on reasonable terms, including the Base Rate Increase, a General Rate Case Filing Plan, a commitment for equity infusions, expense reduction commitments, certain special accounting treatments, as well as performance and reporting requirements and a benchmarking study.

---

[4] This is acknowledged in Settlement paragraph 1.4. As the worldwide financial crisis has unfolded, the spread between the required yield for investment grade and "junk" rated debt may have even expanded beyond the point when this estimate had been made, and whether there is even a market now for issuing new "junk" rated debt is somewhat doubtful.

Q. Mr. Johnson, what is Staff's view concerning when new rates should become effective?

A. It is Staff's view that the new rates should become effective no sooner than January 1, 2010.

Q. What does the Settlement Agreement provide in terms of rate stability?

A. Section II-A provides for a General Rate Case Filing Plan in which two APS base rate cases are contemplated with the scheduling and test year specifications provided for each. In Section XXII, the Agreement also provides an opportunity for APS to request a change to its base rates and/or adjustors if an emergency were to arise. An emergency is defined in the Agreement as an extraordinary event that is beyond the control of APS, and would include, for example, an imposition of a federal carbon tax or "cap and trade" system.

SECTION III – POLICY CONSIDERATIONS

Q. Mr. Johnson how does Staff reconcile moving from its recommended revenue requirement in its Direct Testimony to the revenue requirement recommended in the Settlement Agreement?

A. The testimony of Mr. Ralph Smith offers a more complete discussion of the basis for the revenue requirement set forth in the Agreement. In this testimony, I address the policy reasons underlying Staff's support for the revenue requirement set forth in the Agreement.

Q. Mr. Johnson, what was Staff's goal when it agreed to enter into settlement discussions in this matter?

A. The primary goal of Staff in this matter and all matters before the ACC is to protect the public interest, recommend rates that are just, fair and reasonable to the rate payers and the Company. Also, Staff believes that the rate payers will realize important benefits from the Agreement. In addition, Staff's desire is to apply proactive, forward thinking regulatory practices, provide regulatory support and allow the Company a timely recovery of its prudent and necessary investment. We believe we accomplished this goal by reviewing the facts presented and making appropriate recommendations to the Commission for its consideration, which properly balance both Company and rate payer interests.

Q. What were some of the major policy considerations in this Docket?

A. The major policy considerations Staff and the other Signatories dealt with to balance the diverse interests in this case included the following:

- Inclusion of additional revenue requirement to recognize post test year plant through June of 2009, 18 months beyond the test year.
- A higher return on common equity.
- A higher increment to the fair value rate of return.
- Special accounting treatment related to a Palo Verde license extension.
- APS expense reduction commitment.
- Treatment of Schedule 3 receipts as revenue for the benefit of APS.
- Limit on recovery of annual cash incentive compensation for APS executives.
- Continuation of 90/10 sharing.
- Benefits for low-income customers.
- Increased Renewable Energy commitment.
- New Demand-Side Management and Energy Efficiency requirements.
- New Rate Design Options.

Q. Can you please discuss some of the policy considerations?

A. Yes.

Post Test Year Plant

Q Can you please explain why Staff supports the inclusion of post test year plant in rate base?

A. This case must be viewed in the context of the current severe financial crisis and the Company's difficulty in maintaining investment grade bond ratings. In addition, in this instance, Staff supports the inclusion of post test year plant through June 2009, because Staff believes it will help the Company achieve a more timely recovery of its investment, since the Company has committed to make significant infrastructure investments over the next several years. The Company claims that regulatory lag would have more serious consequences given its proposed level of investment in the next few years. Staff desired to address the issue of requlatory lag through the inclusion of post test year plant as contained in the Agreement.

Cost of Capital (Common Equity)

Q. Mr. Johnson, in the Company's last rate application, what was the authorized return on common equity?

A. The Commission, in Decision No. 69663 authorized 10.75 percent return on common equity for APS.

Q. Why is Staff recommending 11 percent in this Settlement Agreement?

A. Staff acknowledges that the recommended cost of common equity is higher than that previously adopted. As discussed earlier, the rationale for such a percentage is to assist the Company in achieving a necessary level of revenues to aid APS in its effort to attract and secure access to capital markets, during this period of extraordinary financial crisis. In addition, the 11 percent is within the range as calculated by Mr. Parcell in his Direct Testimony.

APS Expense Reduction Commitment

Q. Has the Commission, in its previous decision, required APS to commit to an annual expense reduction?

A. Yes. Decision No. 70667 required APS to reduce its operational expenses by $20 million. The Agreement increases this amount by $10 million, from $20 to $30 million on average per year over the Plan Term.

Fuel and Power Supply Adjustment

Q. Did APS request the elimination of the 90/10 sharing provision in the current PSA?

A. Yes.

Q. How does the Settlement Agreement address this provision?

A. Paragraph 6.1 of the Agreement provides that the 90/10 sharing provision in the current PSA will be continued for purposes of the resolution of this rate case.

Equity Infusions

Q. Mr. Johnson, can you please briefly describe the provision Section VIII.

A. Yes, pursuant to Section VIII of the Agreement, APS agrees to complete equity infusions of at least $700 million during the period beginning June 1, 2009 through December 31, 2014. Equity infusions are an important component of this Agreement. This provision should assist the Company in maintaining investment grade financials. The Agreement also requires the Company to strive to achieve a capital structure of no more than 52% debt/total capital as calculated by the credit rating agencies by December 31, 2012.

Q. Can you please explain why this provision is important?

A. APS, in its current as well as its previous rate case, has asserted that the credit rating agencies have looked at the Company's rating in an unfavorable way. APS, in the past, has focused on its FFO to debt ratio, which it claims is a key financial metric used by the rating agencies. Staff believes if and when the Company receives the equity infusions of at least $700 million equity that are required in the Agreement, other things being equal, this should increase the FFO to debt ratio and thus help improve APS' bond ratings. In addition to the equity infusions commitment, the Agreement also provides, at paragraph 8.4, that APS shall prepare and submit a plan to the Commission and Signatories detailing the steps APS intends to take to maintain and improve its financial ratings with the credit rating agencies.

Pension and OPEB Deferrals

Q. Why did Staff agree with the Pension and OPEB expense deferrals that are provided for in Section IX of the Settlement Agreement?

A. This agreement was reached through intense negotiations, as I have described, and represents a balancing of many diverse interests. From a policy perspective, the primary reason Staff agreed to the limited deferral of APS' pension and OPEB costs in 2011 and 2012 that is provided for in Section IX of the Agreement was to provide support for APS' earnings in those years in conjunction with the General Rate Case Filing Plan that is addressed in the Agreement at Section II-A.

Q. If the Commission has specific questions about the accounting or the amounts listed in Section IX, is another Staff witness addressing such details?

A. Yes. Staff witness Ralph Smith's testimony provides additional details concerning the accounting and amounts related to this matter that are listed in the Agreement at Section IX.

Schedule 3

Q. Mr. Johnson, can you please explain the Commission's current policy as it is relates to Schedule 3.

A. Yes. Currently, Schedule 3 receipts are recorded as Contributions in Aid of Construction ("CIAC").

Q. Please explain how Staff and the Signatories proposed to treat the receipts from Schedule 3 in the Agreement.

A. Staff and the Signatories propose to treat Schedule 3 receipts as revenue to APS during the period from January 1, 2010 through either the earlier of December 31, 2012 or the conclusion of the Company's next general rate case. That is, APS would record Schedule 3 receipts as revenue (and not as CIAC) during this period.

Q. Why did Staff depart from the current Commission policy on the accounting treatment for Schedule 3 receipts?

A. As stated earlier in my testimony, the Settlement negotiation involves give and take. APS in its Application requested a rate increase in the amount of $488 million. The Agreement provides for a lower amount, and also contains a General Rate Case Filing Plan that is intended to prevent APS from immediately filing for another base rate increase. Staff's rationale for agreeing with the treatment of Schedule 3 as revenue is part of the overall framework of the Agreement and was to provide a source of additional revenues to the Company by a means other than an additional base rate increase. Having APS record Schedule 3 receipts as revenue also should improve the Company's financial metrics, such as its FFO to debt ratio, and thus should help APS improve its bond rating during the General Rate Case Filing Plan period, i.e., through December 31, 2014.

Q. Did the Agreement propose any changes to APS' Schedule 3 tariff?

A. Yes. The Agreement would result in several significant improvements to the Company's current Schedule 3 tariff. The Agreement requires APS to file a revised Schedule 3 to reflect the following modifications before the hearing in this case: 1) a clarified definition of local facilities, 2) a schedule of charges, 3) a statement that quotes provided to customers will be itemized, and 4) procedures for refunding amounts to customers when additional customers connect to the line extension.

Q. Mr. Johnson, do you believe this Agreement protects the public interest?

A. Yes, I do. As stated previously in my testimony, this Agreement strikes an appropriate balance between numerous competing interests. This balance includes the need for APS' customers to pay rates that are just and reasonable and that allow APS the opportunity to earn a reasonable return on its investment in providing electric utility services.

Q. Does this Agreement strike an appropriate balance between the diverse needs of the interested parties?

A. Yes, it does. I have discussed the many benefits to consumers beginning at page 7 of my testimony.

The Agreement also addresses and resolves all of the main rate case issues, provides sufficient revenues and return for APS to maintain reliable electric service, and results in rates and charges which Staff believes are just and reasonable. Because of these features and the others described in my testimony, from a policy perspective, Staff believes that this Agreement strikes an appropriate balance between numerous competing interests.

Low-Income Program

Q. What impact will the Settlement have on low-income customers?

A. As previously stated, the Settlement provides for no increase in base rates to low-income customers. It was the parties' intent to insulate current and future low-income customers from a base rate increase. As a result, if the Agreement is approved, low-income customers would not see a base rate increase in their utility rates, nor would they be subject to the costs associated with the Power Supply Adjustment ("PSA") and the DSM adjustor rate.

Q. Please explain other/additional benefits to low-income customers.

A. As stated in the Agreement, consistent with Decision No. 69663, APS will modify its current bill assistance program, to offer assistance to customers whose incomes exceed 150 percent of Federal Poverty Income Guidelines but are less than or equal to 200 percent.

The Plan Term established the funding level of five million dollars, to assist in the bill assistance program. The five million dollars will be funded by APS.

Additional benefits to low-income customers are set forth in Section 16.4, which provides that APS will waive the collection of additional deposits from qualifying low-income customers.

Q. As a policy matter, why should the Commission approve the Agreement?

A. The Agreement addresses and resolves all of the major rate case issues and results in rates which we believe are just and reasonable. Staff believes that the agreed-upon revenue requirement is sufficient for APS to maintain reliable service to its customers and to provide an opportunity for APS to earn a fair return for its investors.

SECTION IV – COMMISSIONERS LETTERS

Q. Mr. Johnson are you aware that Chairman Mayes, Commissioner Pierce, Commissioner Newman, Commissioner Kennedy and Commissioner Stump all placed letters in the docket requesting that the parties address in testimony or Settlement various issues raised in the filing?

A. Yes. I have reviewed all the letters docketed by the Commissioners.

Chairman Mayes' Letters

Q. Mr. Johnson, does the Agreement address the issues raised by Chairman Mayes' letters dated January 27, 2009 and June 9, 2009?

A. Generally yes.

Q. Please explain the topics raised in these letters.

A. On January 27, 2009, Chairman Mayes in her letter expresses a view that the Commission should not address the result of any proposed settlement agreement until the Company has complied with the provision in Decision No. 70667 which called on APS to pare $20 million in operating expenses.

Q. Has the Company complied with Decision No. 70667?

A. Yes.

Q. What other topics were raised by the letter?

A. Other topics include Energy Efficiency, Renewable Energy, low-income customers, and time-of-use ("TOU").

Q. Did the Agreement address these issues?

A. Sections XIV (DSM), XV (Renewable Energy), XVI (low-income progams) and XXI (time-of-use for K-12 schools) address these issues.

Q. Mr. Johnson, can you please briefly explain those Sections.

A. Yes. Section XIV (DSM) establishes energy efficiency goals, which define an annual energy savings of 1.0% in 2010, 1.25% in 2011 and 1.5% in 2012.

Section XV requires APS to make its best effort to acquire new renewable energy resources with annual generation or saving of 1.7 million MWh to be in service by December 31, 2015.

Section XVI exempted low-income customers from the base rate increase, offers assistance for customers whose incomes exceed 150% but are less than 200% of the Federal poverty income guidelines. APS will fund this program in the amount of $5 million.

Section XXI addresses the issue of a new optional TOU rate for K-12 schools.

Q. Please list the issues in the letter dated June 9, 2009.

A. The letter covers topics including:

- Future rate cases (filing and processing)
- Return on equity
- Schedule 3
- Utility-scale solar project
- In-state wind generation
- Energy efficiency goals
- Renewable Energy Standard
- Feed-in tariff
- Carbon credits

Q. Mr. Johnson, have any of the issues listed above been addressed in your testimony or in other Staff members testimonies?

A. Yes. The following topics were addressed. Future rate case, return on equity, and Schedule 3 are all addressed in this testimony.

Barbara Keene, in her testimony, addresses utility-scale solar project, in-state wind generation, Renewable Energy Standard, and energy efficiency goals.

<u>Commission Pierce's Letter</u>

Q. Mr. Johnson, does the Agreement address the issue raised by Commissioner Pierce's letter dated February 9, 2009?

A. Generally yes.

Q. Please explain the issue raised in Commissioner Pierce's letter.

A. The February 9, 2009, letter covers the topic relating to low-income customers.

Q. Did the Agreement address the issues raised in the letter?

A. Yes. Section XVI of the Agreement addresses this issue. Additionally, Staff provided the following responses to Commissioner Pierce's questions.

Q. ***What was APS' average number of low income customers each month?***
A. *47,219 (see Exhibit A attached for detail).*

Q. ***What was the average and median usage (kWh per month) for these customers?***
A. *The average usage is 1.034 kWh and the median usage is 847 kWh.*

Q. ***For the ten highest use low-income customers, what was the average and median usage?***
A. *The average usage is 6,154 kWh and the median usage is 6,283 kWh.*

Q. ***For the ten lowest use low-income customers, what was the average and median usage?***
A. *The average usage is 12 kWh and the median usage is 12 kWh.*

Q. ***What was APS' average number of low income customers each month?***
A. *46,775 (see Exhibit A attached for detail).*

Q. ***What was the average and median usage (kWh per month) for these customers?***
A. *The average usage is 702 kWh and the median usage is 582 kWh.*

Q. ***For the ten highest use low-income customers, what was the average and median usage?***
A. *The average usage is 5,192 kWh and the median usage is 5,106 kWh.*

Q. ***For the ten lowest use low-income customers, what was the average and median usage?***
A. *The average usage is 15 kWh and the median usage is 14 kWh.*

Commissioner Newman's Letter

Q. Mr. Johnson, does the Agreement address the issues raised by Commissioner Newman's letter dated April 24, 2009?

A. Generally yes.

Q. Please explain.

A. The April 24, 2009, letter covers the topic of line extension policies.

Q. Did the Agreement address the item in the letter?

A. Yes. Section X of the Agreement addresses Schedule 3 (line extensions). In addition, on May 19, 2009, Staff filed in this docket a response to Commissioner Newman's letter to address the issues raised. Reproduced in this testimony are the responses to Commissioner Newman's questions.

Q. What cost would consumers incur if the Commission were to limit the free footage extension to 500 feet instead of the 1,000 feet?

A. All other things being equal, the impact on customer rates in a subsequent APS rate case would most likely be lower if a 500 foot rather than a 1,000 foot free-footage allowance was instituted, because APS' investment in the line extensions would be lower. The actual cost (impact on rates) would depend on the number of extensions in any given year. Cumulatively, the cost for these extensions out to 1,000 feet, when the free footage policy is initially borne by the utility. At the next rate case, the utility then has an opportunity to apply for recovery of the costs it paid to extend service. The utility's investment, if prudent and reasonable, is recognized in rate base and earns a return. The utility also records depreciation expense on such investment. The return on rate base and the depreciation are recognized in the context of a test year and affect rates prospectively. If the free footage were reinstated at the previous 1,000 feet, or some other level, APS (rather than the customer seeking the line extension) would be financing the amount of investment covered by the free-footage allowance. The actual costs of the line extensions to be financed by APS would not be borne by ratepayers until the conclusion of APS' next rate case.

Q. How many requests for free footage did APS receive over the last five years, by year?

A. It is Staff's understanding that APS does not track the number of requests for free footage, but does track work orders for line extensions that were made that would have fallen under the 1000-foot "free footage" provision that had previously been in effect. In response to a Staff informal data request, APS has provided the following information concerning the number of such work orders in each year:

Year	No. of Work Orders for Extensions Under 1000 Feet
2005	1,300
2006	1,783
2007	1,374
2008	419
Total	4,876

Q. How many of the requests came from out of state landowners?

A. APS has advised Staff that APS does not track requests by state of residence. Staff does not have this information.

Q. How many of the requests were from developers as opposed to homeowners?

A. APS has advised Staff that the free footage provision was not available to developers, consequently; there have been none.

<u>**Commissioner Kennedy's Letters**</u>

Q. Mr. Johnson, does the Agreement address the issues raised by Commissioner Kennedy's letters dated April 1, 2009 and April 29, 2009?

A. Generally yes.

Q. Please explain the issues raised in Commissioner Kennedy's April 1, 2009 letter.

A. The April 1, 2009, letter covers topics including:

a. Houses of worship tariff
b. Demand-side Management Adjustor charge in relation to houses of worship and low-income customers

Q. Did the Agreement address all of the items in the letters?

A. Yes. Section XXI.1 of the Agreement addresses the issue of houses of worship. The Agreement requires APS to unfreeze the existing rate schedule E-20 for a period of 12 months to allow for additional customer participation. Section XVI recognizes that low-income customers shall be exempt from the DSMAC.

Q. Mr. Johnson, are there other issues raised in Commissioner Kennedy's April 1, 2009 letter that were not addressed in the Agreement?

A. Yes. The Agreement did not address the issue of holding houses of worship harmless from paying the DSMAC.

Q Can you please discuss the issue raised in Commissioner Kennedy's letter dated April 29, 2009?

A. Yes, the April 29, 2009 letter raised the issue of line extension. Section X of the Agreement addresses Schedule 3 (line extension). In addition, on May 19, 2009, Staff filed in this Docket, a response to Commissioner Kennedy's letter to address the issues raised. Reproduced in this testimony are the responses to Commissioner Kennedy's letter.

> ***Q. APS and all parties to this docket that have been affected by this line extension policy (i.e., no free footage), please provide details on exactly how this policy has negatively or positively affected you and/or the persons/entities that you represent.***
>
> *A. Although Staff is not directly affected by the no-free footage policy, Staff attempts to balance the ratepayer and utility interests in the evaluation of this issue. Staff has received recent consumer complaints relating to APS' Schedule 3. Generally, these complaints fall into the categories of (1) the costs quoted appearing too high and (2) quoted costs are not itemized. See attached summaries of consumer complaints.*
>
> *With respect to the utility interest, the likely effect is the possibility of a timing impact for the utility in the recovery of these costs.*
>
> *Useful background information appears in the January 29, 2008 Staff Report which is attached for your convenience.*

Q. APS, Utilities Division Staff ("Staff") and the Residential Utilities Consumers Office ("RUCO"), please explain how the effect of the APS' no-free-footage line extension policy is being taken into consideration in APS' pending rate case.

A. Staff is not proposing any changes to the no-free-footage policy because it is the Commission's current policy on line extensions for electric utilities. It was first adopted for APS in Decision No. 69663 and has been subsequently adopted in other electric company rate cases. Consistent with the May 4, 2009 Term Sheet under Section II(B)(3) "Treatment of Schedule 3," Staff recommends the following in APS' pending rate case:

"APS' Impact Fee proposal in the rate case would be withdrawn.

The System Facilities Charge proposed by APS shall be withdrawn.

Upon Commission approval of this settlement, APS shall file in this docket a revised Schedule 3 that is consistent with the Decision and includes clarification of charges, definitions, a schedule of charges and a requirement by APS to itemize customer quotes among other matters. In light of the Commission's continued interest in this issue, the Settlement Agreement may contain additional provisions for Schedule 3 that are revenue neutral to this settlement."

Q. APS, Staff and RUCO, please explain what benefits, if any, APS ratepayers may derive in APS' pending rate case from APS' no-free-footage line extension policy.

A. In a settlement in principle that has been reached between APS and many other parties to the rate case, APS would account for the Schedule 3 receipts as revenue (as opposed to CIAC) for a specified period. This provision is intended to help bolster APS' financial position and credit ratings and help avoid having APS immediately file another general rate case and/or another emergency rate increase request.

Q. APS, Staff and RUCO, please explain what detriments, if any, APS ratepayers may see in APS' pending rate case as a result of APS' no-free-footage line extension policy.

A. The no-free footage line extension policy can create a financial burden on new customers who no longer can avail themselves of a line extension policy that includes an allowance for free footage. The costs to individual customers of line extensions, where there is no free footage allowance, can be significant. Please see also the response to question 1 above.

Q. APS, Staff and RUCO, please explain what benefits, if any, APS ratepayers may derive in the future if APS maintains its current no-free-footage line extension policy.

A. The benefits to APS' existing ratepayers, if APS maintains its current no-free-footage line extension policy, is that costs related to growth (i.e., line extension costs) are borne to a larger extent by the new customers, who pay the higher cost *for those line extensions. The no-free-footage line extension policy was originally adopted during a time of rapid economic growth. The main reason for adopting the no-free-footage line extension policy was to have the causers of growth (new construction) pay more fully for the impacts of such growth, and to help minimize the impact of such rapid growth upon existing customers.*

Ultimately, the benefit to ratepayers in the future from the current no-free-footage line extension policy is dependent upon the accounting and ratemaking treatment in a future APS rate case.

If the payments APS receives for line extensions are accounted for as revenue, and that revenue is fully recognized in the context of a future APS rate case, there would be a dollar for dollar reduction to the revenue requirement for the line extension revenue received in the test year.

If the payments APS receives for line extensions are accounted for as revenue, and that revenue is <u>*not*</u> *recognized in the context of a future APS rate case, the benefit would inure primarily to APS and its shareholders, via increased cash flow and increased earnings, rather than to APS' ratepayers. To the extent that such increased cash flow and higher earnings assist APS in maintaining or improving its financial profile and raising its credit rating, there may be an indirect benefit experienced by ratepayers in the form of lower financing costs in a future APS rate case.*

To the extent the payments APS receives for line extensions are accounted for as Contributions in Aid to Construction ("CIAC"), there would be a reduction to rate base in a future APS rate case. Additionally, as the CIAC is amortized, there would be a reduction to expenses.

A simple, illustrative single-test-year example of such impacts is as follows. Assume that in the test year in APS' next rate case, APS received $10 million in new customer payments for line extensions under 1,000 feet pursuant to the current no-free-footage line extension policy.

If this $10 million is accounted for as revenue, and that revenue is fully recognized in the test year in APS' next rate case, the revenue requirement to existing customers would be reduced by approximately $10 million.

If the $10 million were recognized as CIAC, rate base would be reduced by $10 million, less a related impact from Accumulated Deferred Income Taxes ("ADIT"), such that the net rate base deduction would be approximately $6 million. (This assumes for simplicity a combined federal and state income tax rate of 40 percent. The combined tax rate Staff used in the pending APS rate case is 39.36 percent.) In the context of that next APS rate case, the revenue requirement would be reduced by an amount that can be estimated by applying a pre-tax rate of return to the net rate base reduction, or approximately $746 thousand, plus the impact of CIAC *amortization, estimated at $333 thousand per year, assuming for simplicity a 30-year amortization period, for a total reduction to the revenue requirement of approximately $1.1 million.*

The benefits (and detriments) from the revenue versus CIAC treatment vary over time. The benefit from the revenue accounting treatment is short-term and basically occurs only for rates established based on the test year in which the line extension receipts were recognized as revenue. The benefit from the CIAC accounting is cumulative and builds over time. A more detailed comparative analysis of the impact of the alternative accounting and ratemaking treatments over time, and on a net present value basis, was attached to Staff witness Ralph Smith's direct testimony as Attachment RCS-6.

In order to provide additional perspective in answering this question, we will also discuss a scenario that assumes that the current no-free-footage line extension policy was <u>not</u> in effect during the test year presumed in the above illustrative example. Under this scenario, APS (rather than the new customers) would be required to finance the $10 million of new plant represented by the line extensions that were now presumed to be covered by a free-footage allowance. Under this scenario, there would be no CIAC offset to rate base, since APS was paying for the plant additions, and existing customers would then experience a revenue requirement that was higher than the one described above in the CIAC accounting example. In other words, because the CIAC offset to rate base did not exist, APS (rather than new customers) paid for the line extension costs attributable to the free footage allowance. As a consequence, the revenue requirement to existing customers would be higher by approximately $1.1 million.

As noted above, the impact from CIAC is cumulative over time. The revenue requirement burden on existing customers from line extension costs that are not addressed by CIAC would thus be expected to grow over time.

Q. APS, Staff and RUCO, please explain what detriments, if any, APS ratepayers may see in the future if APS maintains its current no-free-footage line extension policy.

A. See response to question 4 above. In addition, the detriment that APS customers may see in the future is dependent upon the accounting and ratemaking treatment applied to line extension receipts in future APS rate cases, as explained in response to question 5. Different accounting and ratemaking treatments that could be applied to the payments APS receives for line extensions can have different short- and long-term impacts upon APS' revenue requirement in future rate cases. To the extent that APS ratepayers may experience short-term benefits related to a particular accounting and ratemaking methodology applied to receipts by APS under its current no-free-footage line extension policy, the consistent application of that method may also entail long-term detriments to APS ratepayers related to higher costs in the future.

Q. ***APS, Staff and RUCO, please explain what benefits and/or detriments, if any, APS ratepayers may see in APS' pending rate case if APS' no-free-footage line extension policy were modified in this case to allow some amount of free footage or monetary allowance. For example purposes, assume a free footage of 750 feet and a monetary allowance of $5,000.***

A. *A benefit would be realized by new customers who would pay less for a new line extension. This modification to the line extension policy would impact APS and its existing ratepayers prospectively. At some point, likely in the rates resulting from APS' next general rate case, the impacts of this policy would begin to affect current ratepayers.*

It would also affect APS' cash flow and earnings prospectively. Reinstating a free footage allowance and having a monetary allowance would be expected to reduce APS' cash flow, all other things being equal. It is unclear to what extent such a change would impact APS' credit ratings during the period between rate cases.

Q. ***APS, Staff and RUCO, please explain what benefits and/or detriments, if any, APS ratepayers may see in the future if APS' s no-free-footage line extension policy were modified in this case to allow some amount of free footage or monetary allowance. Again, for example purposes, assume a free footage of 750 feet and a monetary allowance of $5,000.***

A. *See response to question 7 above.*

<u>Commissioner Stump's Letter</u>

Q. Mr. Johnson, does the Agreement address the issues raised by Commissioner Stump's letter dated April 23, 2009?

A. Generally yes.

Q. Please explain the issues raised in Commissioner Stump's letter dated April 23, 2009.

A. The April 23, 2009, letter covers the issue of line extension policies.

Q. Did the Agreement address the item in the letter?

A. Yes. Section X of the Agreement addresses Schedule 3 (line extensions). In addition, on May 19, 2009, Staff filed in this docket a response to Commissioner Stump's letter to address the issues raised. Reproduced in this testimony are the responses to Commissioner Stump's questions.

Q. What cost would consumers incur if the Commission were to re-instate the 1,000 foot free-line extension?

A. The actual cost (impact on rates) would depend on the number of extensions in any given year. It would also depend upon whether the related provisions of Schedule 3 were also reinstated. Cumulatively, the cost for these extensions out to 1,000 feet, when the free footage policy is in effect, is initially borne by the utility. At the next rate case, the utility then has an opportunity to apply for the costs it paid to extend service to be placed in rate base and then earn a return on and of those costs from all ratepayers. If the free footage were reinstated, APS would revert to the prior treatment of the line extensions. Under that methodology, the actual costs of the line extensions would not be borne by ratepayers until the conclusion of APS' next rate case.

Q. Should there be a cap on the amount a utility can charge the development for the extension?

A. The maximum, amount a utility should be able to charge is its actual cost for the constructing the line extension. Capping the amount that a utility could charge for extensions could lead to cross-subsidization among ratepayers. For example, in the event that a line extension cost more than the capped amount, the excess will be borne by existing ratepayers when it is placed into APS' rate base. To that extent, having a cap introduces a potential subsidization of new customers by existing customers.

Q. If a utility were to put in a line extension, is there is a benefit to all users in that extension area, including the utility and its customers?

A. It depends on how it is implemented. If the utility makes use of appropriate regional planning as part of extending new infrastructure, bringing new customers onto the system is generally a benefit to all users. New customers help to spread rate impacts. Further, new infrastructure that is implemented with regional considerations in mind should benefit the system. However, if extensions are planned with too narrow a scope, benefits may be confined to only the customer being served.

Q. If a developer were to put in the extension, would the developer be subsidizing all development which occurs later?

A. See the answer to Question 3. It would depend on the configuration of the extension and whether it was tailored only to meet the developer's immediate needs or if regional/system considerations were used.

Q. What policies, if any, could be put into place to re-pay the initial developer for the 1,000 foot free-line extension?

A. Although developers did not receive a 1,000 foot free extension under the previous version of Schedule 3, that schedule contained another provision for an economic feasibility analysis to determine the amount of free footage allowance. The economic feasibility provision allowed the possibility of refunding amounts advanced by the developer for the construction of line extension facilities. This provision of Schedule 3 was also eliminated in the last general rate case. One way to establish a means to refund the initial developer would be to revert to the old policy that was in place prior to the elimination of the economic feasibility analysis.

Q. What is the average cost to a developer to put in the line extension?

A. The average cost to the developer is going to depend on a number of factors, including the length of the line extension, the number of homes being connected, the capability of the existing distribution backbone where the interconnection will take place, and the local geographic conditions, such as terrain, soil conditions, etc. There are several reported figures. In Docket E-01345A-05-081, in the direct testimony of David Rumolo, APS reported costs in excess of $10,000 per 1,000 feet of line-extension. In that same Docket, Mr. Rumolo also testified that the reproduction cost of the net distribution investment to serve residential customers would be approximately $2,700. This cost estimate may be low, however, as it excludes substation equipment. In the current rate case, APS has reported that its growth-related costs in 2006-2007 totaled $521 million. In that two-year time period, APS added 78,670 customers. This suggests an average cost per new customer of approximately $6,623.

Q. What is the average cost to an individual homeowner to put in the line extension?

A. The average cost to an individual homeowner would depend on a number of factors, including the length of the line extension and the local geographic conditions, such as terrain, soil conditions, etc. In addition, see the response to question 6 above.

Q. Mr. Johnson, do the parties believe an increased commitment to renewable energy is a ratepayer benefit that should be offered as part of the Settlement Agreement?

A. Yes.

Q. Does this conclude your testimony?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. E-01345A-08-0172

DIRECT TESTIMONY

SUPPORTING THE SETTLEMENT AGREEMENT

OF

BARBARA KEENE

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 01, 2009

TABLE OF CONTENTS

APPENDICES

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172

This testimony addresses provisions of the Settlement Agreement, including Power Supply Adjustment Plan of Administration, Treatment of Schedule 3, withdrawal of APS' Impact Fee proposal, withdrawal of APS' System Facilities Charge proposal, revisions to Schedule 3, Demand-side Management, and Renewable Energy.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Barbara Keene. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. By whom are you employed and in what capacity?

A. I am employed by the Utilities Division of the Arizona Corporation Commission as a Public Utilities Analyst Manager. My duties include supervising the energy portion of the Telecommunications and Energy Section. A copy of my résumé is provided in Appendix 1.

Q. As part of your employment responsibilities, were you assigned to review matters contained in Docket No. E-01345A-08-0172?

A. Yes.

Q. What is the subject matter of this testimony?

A. This testimony will provide support for the Settlement Agreement ("Agreement") filed on June 12, 2009, by addressing the following sections of the Agreement:

Section VI.	Fuel and Power Supply Adjustment Provisions
6.4	Plan of Administration
Section X.	Treatment of Schedule 3
10.5	withdrawal of APS' Impact Fee proposal
10.6	withdrawal of APS' System Facilities Charge proposal
10.7	revisions to Schedule 3
Section XIV.	Demand-side Management
Section XV.	Renewable Energy

SETTLEMENT AGREEMENT

Fuel and Power Supply Adjustment Provisions

Q. What does the Agreement contain in regard to Power Supply Adjustment ("PSA")?

A. Section VI of the Agreement provides for some modifications to the PSA of Arizona Public Service Company ("APS"). Subsection 6.4 provides that the PSA Plan of Administration would be amended to reflect those modifications, and the Plan of Administration would be approved by the Commission concurrent with approval of the Agreement.

Q. Please describe the revisions to the PSA Plan of Administration.

A. The revisions will include adding reference to gains on SO_2 allowances, updating the base cost of fuel and purchased power, and removing outdated language.

Q. Was the revised PSA Plan of Administration filed with the Agreement?

A. No, APS has filed a revised PSA Plan of Administration on June 29, 2009.

Q. When does Staff expect to complete its review of the revised PSA Plan of Administration?

A. Staff expects to complete its review of the revised PSA Plan of Administration after this testimony has been filed and would therefore address it in reply testimony

Treatment of Schedule 3

Q. What does the Agreement contain in regard to Schedule 3?

A. Section X of the Agreement contains provisions regarding APS' line extension policy ("Schedule 3"). This testimony covers subsections 10.5, 10.6, and 10.7. Other Staff witnesses will discuss policy and treatment of proceeds.

Q. What is included in subsection 10.5?

A. APS had included a proposal for an Impact Fee in its rate case application. APS had described the purpose of the Impact Fee as allowing APS to recover certain growth-related expenses either caused by Schedule 3 or not recovered by Schedule 3. Subsection 10.5 of the Agreement provides for APS to withdraw the proposed Impact Fee. However, APS would be allowed to discuss impact or hook-up fees in the Commission's generic docket on hook-up fees.

Q. What is included in subsection 10.6?

A. APS had included a proposed System Facilities Charge in the Schedule 3 included in its rate case application. The purpose of the System Facilities Charge was to recover the costs associated with improvements to APS facilities necessary to support APS' aggregated load serving and voltage regulation requirements as a result of new growth. Subsection 10.6 of the Agreement provides for APS to withdraw the proposed System Facilities Charge.

Q. What is included in subsection 10.7?

A. Subsection 10.7 provides for APS to make some modifications to Schedule 3 to enhance clarity and provide transparency of costs.

Q. Please describe the modifications.

A. The term "Local Facilities" will be defined so as to make clear what type of facilities are included in the line extension cost estimates provided to customers. In addition, APS will be itemizing those cost estimates. There will be language in Schedule 3 to express the current practice of allowing customers to hire contractors for trenching, conduit, and backfill necessary for underground extensions. Schedule 3 will contain procedures for refunding amounts to customers when additional customers connect to a line extension. Furthermore, Schedule 3 will contain a Schedule of Charges so that customers will know what the charges will be for specific items and that the charges are consistently applied to all customers seeking a line extension. The Schedule of Charges would be approved by the Commission when the revised Schedule 3 is approved concurrent with approval of the Agreement.

Q. Was the revised Schedule 3 filed with the Agreement?

A. No, APS has filed the revised Schedule 3 on June 29, 2009.

Q. When does Staff expect to complete its review of the revised Schedule 3?

A. Staff expects to complete its review of the revised Schedule 3 after this testimony has been filed and would therefore address it in reply testimony.

Demand-side Management

Q. What does the Agreement contain in regard to demand-side management ("DSM")?

A. Section XIV of the Agreement provides for energy efficiency goals (14.1), a modified performance incentive (14.2), self-direction (14.3-14.5), a modified DSMAC (14.6-14.7), no recovery of unrecovered fixed costs in this rate case (14.8), annual Implementation Plans (14.9-14.10), and components of the 2010 Implementation Plan (14.11).

Q. What is energy efficiency?

A. Energy efficiency is a type of DSM that consists of products, services, or practices aimed at saving energy in end-use applications generally by substituting technically more advanced (compared to what is presently used in a specific situation) equipment or practices to produce the same or an improved level of end-use service with less energy use.

Q. Please describe the energy efficiency goals contained in the Agreement.

A. APS would have to meet energy efficiency goals defined as annual energy savings expressed as a percent of total energy resources needed to meet retail load. The goals are shown in Table 1. If the Commission were to adopt higher energy efficiency goals in another docket, the higher goals would supersede the goals in the Agreement.

Table 1
Energy Efficiency Goals

Year	Energy Savings as % of Total Energy Resources	Cumulative Energy Savings
2010	1.00 %	1.00 %
2011	1.25 %	2.25 %
2012	1.50 %	3.75 %

Q. Please describe the modified performance incentive.

A. The performance incentive allows customers and the utility to share the overall net benefits of the energy efficiency portfolio. Currently, customers receive 90 percent and APS receives 10 percent of the net benefits of energy efficiency programs up to a cap of 10 percent of reporting period DSM spending. Under the Agreement, the performance incentive becomes tiered, relative to achieving levels of the energy efficiency goals. See Table 2.

Table 2
Tiered Performance Incentive

% of Energy Efficiency Goal Achieved	Performance Incentive as % of Net Benefits	Performance Incentive Capped at % of Program Costs
< 85 %	0 %	0 %
85 % - 95 %	6 %	12 %
96 % - 105 %	7 %	14 %
106 % - 115 %	8 %	16 %
116 % - 125 %	9 %	18 %
> 125 %	10 %	20 %

Q. What is Self Direction?

A. Self Direction is an option made available to large customers who choose to reserve their DSM contributions for funding projects at their own facilities.

Q. What does the Agreement provide in regard to Self Direction?

A. The Agreement provides for commercial or industrial customers who use more than 40 million kWh per year (based on aggregation of all of the customer's accounts) to Self Direct 85 percent of the customer's DSM contributions. Details of the Self Direction option are included in Attachment C of the Agreement.

Q. What is the DSMAC?

A. The DSMAC ("Demand-side Management Adjustor Clause") is the adjustor mechanism through which APS recovers prudently incurred DSM program and related costs incurred by APS, above the $10 million included in base rates, in connection with Commission-approved DSM programs and activities. Allowable costs include costs for rebates or other incentives, including rebate processing; training and technical assistance; customer education; program planning and administration; program implementation; marketing and communications; monitoring and evaluation; and baseline studies. APS also is allowed to collect the performance incentive discussed above. APS currently collects DSM costs through the DSMAC after the costs are incurred.

Q. How would the Agreement modify the DSMAC?

A. The Agreement provides for APS' DSMAC to be modified to allow for more current recovery of DSM costs, similar to the DSM adjustor approved for Tucson Electric Power in Decision No. 70628.

Q. How would the DSMAC rate be calculated?

A. The total amount to be recovered through the DSMAC would be calculated by projecting DSM costs for the next year, adjusted by the previous year's over- or under-collection, and adding the revenue to be recovered from the performance incentive. The total amount to be recovered would be divided by the projected retail sales ("kWh") for the next year to calculate a per kWh rate, except for demand-billed General Service customers who would pay a per kW rate. The Agreement continues the exemption of qualifying low income customers from the DSMAC charge that was established by this Commission in Decision No. 70961. All customers, except those on low income rates E-3 and E-4 and those on solar rates Solar-1, Solar-2, and SP-1, would pay the DSMAC rate. Interest would be applied only when an over-collected balance results in a refund to customers. The interest rate would continue to be based on the one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release H-15 and adjusted annually on the first business day of the calendar year. Interest would no longer be applied to an under-recovered balance.

Q. When would the DSMAC rate be reset?

A. The DSMAC rate would be reset annually by the Commission as part of its consideration of the annual Implementation Plans discussed below. After approval, the rate would become effective with the first billing cycle in March.

Q. What is in the Agreement regarding unrecovered fixed costs?

A. Under the terms of the Agreement, APS will not receive recovery of unrecovered fixed costs as a component of DSM program costs in this rate case. APS could seek such recovery in its next rate case or in other proceedings.

Q. What is in the Agreement regarding Implementation Plans?

A. The Agreement provides for APS to file annual Energy Efficiency Implementation Plans for 2010, 2011, and 2012, with new and/or expanded programs or program elements necessary to meet the energy efficiency goals contained in the Agreement. Each Implementation Plan would include estimates of program savings and costs.

Q. When would the Energy Efficiency Implementation Plans be filed?

A. APS will file the 2010 Implementation Plan by July 15, 2009, and the 2011 and 2012 Implementation Plans by June 1, 2010, and June 1, 2011, respectively.

Q. What will be included in the 2010 Implementation Plan?

A. The 2010 Implementation Plan will include, at a minimum:

a. a customer repayment/financing program element within the non-residential programs for schools, municipalities, and small businesses;

b. a goal for at least 100 schools to receive the installation of DSM measures through APS' programs by December 31, 2010;

c. a review of the low income weatherization program for possible enhancement;

d. a Residential Existing Homes Program, consisting of both a new Home Performance element and the existing HVAC element, with a goal of serving at least 1,000 homes through the Home Performance element by December 31, 2010;

e. a non-residential high performance new construction program element; and

f. a residential high performance new home program element to be filed by June 30, 2009.

Q. Will the DSMAC Plan of Administration need to be revised?

A. Yes. The DSMAC Plan of Administration will need to be revised to incorporate the modifications to the DSMAC that are included in the Agreement.

Q. Was the revised DSMAC Plan of Administration filed with the Agreement?

A. No, APS has filed a revised PSA Plan of Administration on June 29, 2009.

Q. When does Staff expect to complete its review of the revised DSMAC Plan of Administration?

A. Staff expects to complete its review of the revised PSA Plan of Administration after this testimony has been filed and would therefore address it in reply testimony

Renewable Energy

Q. What does the Agreement contain in regard to renewable energy?

A. The Agreement provides for APS to exceed the renewable energy requirements of the Renewable Energy Standard and Tariff ("REST") rules.

Q. What are the REST rules?

A. The Commission adopted the REST rules on November 14, 2006 in Decision No. 69127. After certification by the Office of the Arizona Attorney General, the REST rules went into effect on August 14, 2007. The REST rules require APS and other utilities to derive a portion of the retail energy they sell from renewable electricity technologies.

Q. How much renewable energy does the Agreement propose?

A. The Agreement provides for APS to acquire new renewable energy resources with annual generation or savings of 1,700,000 MWh to be in service by December 31, 2015. These new renewable acquisitions, in combination with existing renewable commitments, are estimated to be approximately 10 percent of APS' retail sales by the end of 2015. In contrast, the REST rules requirement is 5 percent in 2015 and 10 percent in 2020.

Q. What specific renewable items does the Agreement address?

A. The Agreement addresses in-state wind generation, utility-scale photovoltaic generation, transmission, solar energy at schools, and solar energy at governmental institutions.

Q. Please describe the in-state wind generation provision.

A. The Agreement provides for APS to issue a request for proposals ("RFP") for in-state wind generation within 90 days of Commission approval of the Agreement. APS would file a request for Commission approval of one or more of the potential projects within 180 days of issuance of the RFP.

Q. Please describe the utility-scale photovoltaic generation provision.

A. Pursuant to the Agreement, APS would file a plan for a utility-scale generation project for Commission approval within 120 days of Commission approval of the Agreement. The project would have a construction initiation date not later than 18 months from the filing date. Selection of the project would be the result of a competitive procurement. This photovoltaic project would be in addition to the concentrated solar power projects already under consideration or previously approved by the Commission.

Q. Please describe the Agreement provisions regarding transmission.

A. After transmission projects are prioritized following the Biennial Transmission Assessment report, APS would begin permitting, design, engineering, right of way acquisition, regulatory authorization, and line siting for one or more new transmission lines or upgrades designed to facilitate delivery of renewable resources to the APS system. APS would then construct such transmission lines or upgrades after obtaining permitting and authorizations.

Q. What does the Agreement contain regarding solar energy at schools?

A. Within 120 days of the Commission Order approving the Agreement, APS would file for Commission approval a new program that eliminates up-front customer costs for on-site solar energy (including photovoltaics, solar water heating, and daylighting) at public and charter K-12 schools. The goal would be 50,000 MWh of annual solar energy generation or savings within 36 months of Commission approval of the program.

Q. What does the Agreement contain regarding solar energy at governmental institutions?

A. Within 120 days of the Commission Order approving the Agreement, APS would file for Commission approval a new program that substantially reduces or eliminates up-front customer costs for distributed solar energy (including photovoltaics, solar water heating, and daylighting) at governmental institutions.

Q. What other provisions are in the Renewable Energy section of the Agreement?

A. The Agreement also provides for APS to recover its reasonable and prudent expenses through the Power Supply Adjustor, a renewable energy adjustment mechanism, or the Transmission Cost Adjustor, as appropriate. The expenses would include the carrying costs of any capital investments by APS in renewable energy projects, depreciation expenses, property taxes, and return on both debt and equity at the pre-tax weighted average cost of capital. Because of this provision, APS would not seek to recover Construction Work in Progress related to any of the renewable projects required by the Renewable Energy section of the Agreement. In addition, APS agrees to the renewable energy commitments in the Settlement Agreement regardless of the outcome of any judicial challenge to the REST rules.

Q. Does this conclude your direct testimony?

A. Yes, it does.

RESUME

BARBARA KEENE

Education

B.S.	Political Science, Arizona State University (1976)
M.P.A.	Public Administration, Arizona State University (1982)
A.A.	Economics, Glendale Community College (1993)

Additional Training

Management Development Program - State of Arizona, 1986-1987
UPLAN Training - LCG Consulting, 1989, 1990, 1991
various seminars, workshops, and conferences on ratemaking, energy efficiency, rate design, computer skills, labor market information, training trainers, and Census products

Employment History

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst Manager (May 2005-present). Supervise the energy portion of the Telecommunications and Energy Section. Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters.

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst V (October 2001-May 2005), Senior Economist (July 1990-October 2001), Economist II (December 1989-July 1990), Economist I (August 1989-December 1989). Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters. Responsible for maintaining and operating UPLAN, a computer model of electricity supply and production costs.

Arizona Department of Economic Security, Research Administration, Economic Analysis Unit: Labor Market Information Supervisor (September 1985-August 1989), Research and Statistical Analyst (September 1984-September 1985), Administrative Assistant (September 1983-September 1984). Supervised professional staff engaged in economic research and analysis. Responsible for occupational employment forecasts, wage surveys, economic development studies, and over 50 publications. Edited the monthly **Arizona Labor Market Information Newsletter**, which was distributed to about 4,000 companies and individuals.

Testimony

Resource Planning for Electric Utilities (Docket No. U-0000-90-088), Arizona Corporation Commission, 1990; testimony on production costs and system reliability.

Trico Electric Cooperative Rate Case (Docket No. U-1461-91-254), Arizona Corporation Commission, 1992; testimony on demand-side management and time-of-use and interruptible power rates.

Navopache Electric Cooperative Rate Case (Docket No. U-1787-91-280), Arizona Corporation Commission, 1992; testimony on demand-side management and economic development rates.

Arizona Electric Power Cooperative Rate Case (Docket No. U-1773-92-214), Arizona Corporation Commission, 1993; testimony on demand-side management, interruptible power, and rate design.

Tucson Electric Power Company Rate Case (Docket Nos. U-1933-93-006 and U-1933-93-066) Arizona Corporation Commission, 1993; testimony on demand-side management and a cogeneration agreement.

Resource Planning for Electric Utilities (Docket No. U-0000-93-052), Arizona Corporation Commission, 1993; testimony on production costs, system reliability, and demand-side management.

Duncan Valley Electric Cooperative Rate Case (Docket No. E-01703A-98-0431), Arizona Corporation Commission, 1999; testimony on demand-side management and renewable energy.

Tucson Electric Power Company vs. Cyprus Sierrita Corporation, Inc. (Docket No. E-00001-99-0243), Arizona Corporation Commission, 1999; testimony on analysis of special contracts.

Arizona Public Service Company's Request for Variance (Docket No. E-01345A-01-0822), Arizona Corporation Commission, 2002; testimony on competitive bidding.

Generic Proceeding Concerning Electric Restructuring Issues (Docket No. E-00000A-02-0051), Arizona Corporation Commission, 2002; testimony on affiliate relationships and codes of conduct.

Tucson Electric Power Company's Application for Approval of New Partial Requirements Service Tariffs, Modification of Existing Partial Requirements Service Tariff 101, and Elimination of Qualifying Facility Tariffs (Docket No. E-01933A-02-0345) and Application for Approval of its Stranded Cost Recovery (Docket No. E-01933A-98-0471), Arizona Corporation Commission, 2002, testimony on proposals to eliminate, modify, or introduce tariffs and testimony on the modification of the Market Generation Credit.

Arizona Public Service Company's Application for Approval of Adjustment Mechanisms (Docket No. E-01345A-02-0403), Arizona Corporation Commission, 2003, testimony on the proposed Power Supply Adjustment and the proposed Competition Rules Compliance Charge.

Generic Proceeding Concerning Electric Restructuring Issues, et al (Docket No. E-00000A-02-0051, et al), Arizona Corporation Commission, 2003-2005; Staff Report and testimony on Code of Conduct.

Arizona Public Service Company Rate Case (Docket No. E-01345A-03-0437), Arizona Corporation Commission, 2004; testimony on demand-side management, system benefits, renewable energy, the Returning Customer Direct Assignment Charge, and service schedules.

Arizona Electric Power Cooperative Rate Case (Docket No. E-01773A-04-0528), Arizona Corporation Commission, 2005; testimony on a fuel and purchased power cost adjustor, demand-side management, and rate design.

Trico Electric Cooperative Rate Case (Docket No. E-01461A-04-0607), Arizona Corporation Commission, 2005; testimony on the Environmental Portfolio Standard; demand-side management; special charges; and Rules, Regulations, and Line Extension Policies.

Arizona Public Service Company (Docket Nos. E-01345A-03-0437 and E-01345A-05-0526), Arizona Corporation Commission, 2005; testimony on the Plan of Administration of the Power Supply Adjustor.

Arizona Public Service Company Emergency Rate Case (Docket No. E-01345A-06-0009), Arizona Corporation Commission, 2006; testimony on bill impacts.

Arizona Public Service Company Rate Case (Docket Nos. E-01345A-05-0816, E-01345A-05-0826, and E-01345A-05-0827), Arizona Corporation Commission, 2006; testimony on funding for renewable resources, net metering, green pricing tariffs, and a Power Supply Adjustor surcharge.

Tucson Electric Power Company Filing to Amend Decision No. 62103 (Docket No. E-01933A-05-0650), Arizona Corporation Commission, 2007, testimony on demand-side management, time-of-use, direct load control, and renewable energy.

Consideration, Pursuant to A.R.S. § 40-252 to Modify Decision No. 67744 Relating to the Self-Build Option (Docket No. E-01345A-07-0420), Arizona Corporation Commission, 2008, testimony on the self-build option for Arizona Public Service Company.

Sempra Energy Solutions Application for Certificate of Convenience and Necessity (Docket No. E-03964A-06-0168), Arizona Corporation Commission, 2008, testimony on the overall fitness of Sempra Energy Solutions to provide competitive retail electric service in Arizona.

Tucson Electric Power Company rate case (Docket No. E-01933A-07-0402), Arizona Corporation Commission, 2008, testimony in support of the Settlement Agreement regarding renewable energy, demand-side management, Rules and Regulations, partial requirements service tariffs, interruptible tariff, demand response, and bill estimation.

Publications

Author of the following articles published in the *Arizona Labor Market Information Newsletter*:

"1982 Mining Employees - Where are They Now?" - September 1984
"The Cost of Hiring" and "Arizona's Growing Industries" - January 1985
"Union Membership - Declining or Shifting?" - December 1985
"Growing Industries in Arizona" - April 1986
"Women's Work?" - July 1986
"1987 SIC Revision" - December 1986
"Growing and Declining Industries" - June 1987
"1986 DOT Supplement" and "Consumer Expenditure Survey" - July 1987
"The Consumer Price Index: Changing With the Times" - August 1987
"Average Annual Pay" - November 1987
"Annual Pay in Metropolitan Areas" - January 1988
"The Growing Temporary Help Industry" - February 1988
"Update on the Consumer Expenditure Survey" - April 1988
"Employee Leasing" - August 1988
"Metropolitan Counties Benefit from State's Growing Industries" - November 1988
"Arizona Network Gives Small Firms Helping Hand" - June 1989

Major contributor to the following books published by the Arizona Department of Economic Security:

Annual Planning Information - editions from 1984 to 1989
Hispanics in Transition - 1987

(with David Berry) "Contracting for Power," *Business Economics*, October 1995.

(with Robert Gray) "Customer Selection Issues," *NRRI Quarterly Bulletin*, Spring 1998.

Reports

(with Task Force) *Report of the Task Force on the Feasibility of Implementing Sliding Scale Hookup Fees*. Arizona Corporation Commission, 1992.

Customer Repayment of Utility DSM Costs, Arizona Corporation Commission, 1995.

(with Working Group) *Report of the Participants in Workshops on Customer Selection Issues*," Arizona Corporation Commission, 1997.

"DSM Workshop Progress Report," Arizona Corporation Commission, 2004.

(with Erin Casper) "Staff Report on Demand Side Management Policy," Arizona Corporation Commission, 2005.

"Staff Report on Interconnection for the Generic Investigation of Distributed Generation," Arizona Corporation Commission, 2007.

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA	DOCKET NO. E-01345A-08-0172

TESTIMONY SUPPORTING THE SETTLEMENT AGREEMENT

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JULY 01, 2009

TABLE OF CONTENTS

ATTACHMENTS

EXECUTIVE SUMMARY
TESTIMONY IN SUPPORT OF SETTLEMENT OF RALPH C. SMITH
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-08-0172

My testimony in support of the Settlement addresses the following sections of the Settlement Agreement:

III. Rate Increase

IV. Cost of Capital

V. Depreciation

VI. Fuel and Power Supply Adjustment Provisions

VIII. Equity Infusions to Be Made by APS

IX. Pension and OPEB Deferrals

X. Treatment of Schedule 3

XI. Adjustment of Depreciation Rates for Palo Verde License Extension

A summary of my testimony concerning the Settlement Agreement for each of these areas follows:

III. Rate Increase.

For Settlement purposes, Staff, Arizona Public Service ("APS"), and a number of other parties to this rate case have agreed to a rate increase that would provide APS with approximately $344.7 million of base rate revenue per year. As shown in the Settlement Agreement, page 13, paragraph 3.8, this $344.7 million is approximately a 13 percent increase over APS's current revenue of $2.637 billion. In dollar terms, the base rate increase over APS's current revenue is approximately $196.3 million, plus $11.2 million for a fuel related increase in base rates, plus $137.2 million for the adjusted base cost of fuel related increase. This is also addressed in paragraph 3.2 through 3.6 of the Settlement.

As described in paragraph 3.5 of the Settlement, the parties agreed to an Arizona jurisdictional fair value rate base for the test year ending December 31, 2007, of approximately $7.666 billion.

Settlement paragraph 3.8 shows how the base rate increase provided for in the Settlement compares with various Signatories' initial proposed increases. It has columns for APS's original filing, Staff's direct filing, Residential Utility Consumer Office's ("RUCO") direct filing, Arizonan for Electric Choice and Competition's ("AECC") direct filing, and the Settlement. The $344.7 million total rate increase is below the amounts recommended in APS' and AECC's direct filings, and is above the amounts recommended in Staff's and RUCO's direct filings.

A portion of the base rate increase had already been put into effect when the Commission granted APS an interim increase of $65.2 million in 2008.

In addition to the amount of base rate increase, the Settlement Agreement also provides for exceptional accounting treatments for APS for Pension and Other Post and Employee Benefit ("OPEB") deferrals (in Section IX), for treating Schedule 3 receipts as revenue (in Section X) and for an adjustment to Palo Verde depreciation rates for a License Extension (in Section XI). Each of these special accounting provisions has future rate consequences for APS ratepayers.

IV. Cost of Capital and Fair Value Rate of Return

The Settlement Agreement at paragraphs 4.1 through 4.3 provides for an overall cost of capital of 8.58 percent and a 6.65 percent fair value rate of return ("FVROR") as shown on Settlement Attachment A. It provides for a return on equity of 11.0 percent, which was the Staff recommendation. The 11.0 percent was at the high end of the range from 9.0 percent to 11.0 percent recommended by Staff witness David Parcell. Staff witness Ernest Johnson's direct testimony, at page 8, explained that Staff's use of the high end of Mr. Parcell's recommended range was intended to aid APS in its efforts to secure access to capital.

Additionally, as explained on page 8 of Staff witness Johnson's direct testimony, as a matter of policy Staff proposed a fair value rate of return ("FVROR") that recognized a 1.5 percent return to the difference between Fair Value Rate Base ("FVRB") and Original Cost Rate Base ("OCRB"). This 1.5 percent return was incorporated into the FVROR for Settlement Purposes, as shown on line 9 of Settlement Attachment A. As shown on Attachment RCS-2 to my direct testimony, Schedule A, page 2, column B, line 8, applying this FVROR to the FVRB provided APS with an additional base rate increase of $51.265 million.

V. Depreciation

Section V of the Settlement Agreement addresses depreciation rates. It provides that APS shall use the depreciation rates contained in Attachment REW-1 to APS witness Ronald White's direct testimony, with the exception of Account 370.01, Electronic Meters, for which APS will continue to use the existing depreciation rate of 3.68 percent.

VI. Fuel and Power Supply Adjustment Provisions

Section VI of the Settlement Agreement addresses the provisions of the Purchased Power Fuel Adjustor Clause that has been agreed to by the parties through the process of negotiation. As provided for in Settlement paragraph 6.1, the 90/10 sharing provision in the current PSA will be continued. The Base Cost of Fuel and Purchased Power is $0.037571 cents per kWh and shall be reflected in APS' base rates. Gains on SO_2 allowances over or under the normalized jurisdictional test year amount reflected in base rates of $7.045 million shall be recovered or refunded through the PSA mechanism. The PSA Plan of Administration will be amended to reflect the terms of the Agreement.

VIII. Equity Infusions into APS

As provided in Settlement paragraph 8.1, APS agrees to complete equity infusions of at least $700 million during the period beginning June 1, 2009 through December 31, 2014. This amount includes the "up to $400 million" previously authorized by the Commission in Decision No. 70454, which authorization expires on December 31, 2009. Equity infusions are an important component of APS using its best efforts to maintain investment grade financial ratios and a balanced capital structure, and its efforts to improve its existing ratings with the financial rating agency community.

IX. Pension and OPEB Deferrals

Section IX of the Settlement Agreement provides for limited deferrals of Pension and OPEB costs in 2011 and 2012 if such costs exceed the test year level, which the parties to the Settlement Agreement have identified as $23.949 million. Deferrals of Pension and OPEB costs that occur under such provisions of the Settlement would present an additional cost to APS' ratepayers in a future rate case. Another witness for Staff, Ernest Johnson, is addressing the policy reasons for this treatment.

X. Treatment of Schedule 3

Section X of the Settlement Agreement at paragraph 10.1 provides for APS to record Schedule 3 receipts as revenue during the period January 1, 2010 through the earlier of December 31, 2012 or the conclusion of APS' next general rate case. Currently, APS records Schedule 3 receipts as Contributions in Aid to Construction ("CIAC"). As stated in paragraph 10.2, APS estimated that its Schedule 3 revenues would be $23 million in 2010, $25 million in 2011 and $49 million in 2012. Recording Schedule 3 receipts as revenue, rather than as CIAC, will have consequences for APS' ratepayers in a future rate case. All other things being equal, rate base in a future APS rate case would be higher because of this treatment. Another witness for Staff, Ernest Johnson, is addressing the policy reasons for this treatment.

XI. Adjustment to Depreciation Rates for Palo Verde License Extension

Section XI of the Settlement Agreement at paragraph 11.1 provides for APS to record lower depreciation expense on Palo Verde to reflect the impact of a license extension that APS anticipates. APS would implement the lower Palo Verde depreciation rates upon the later date of (1) receiving Nuclear Regulatory Commission ("NRC") approval for the Palo Verde license extension, or (2) January 1, 2012. Attachment B to the Settlement Agreement, at pages 5-6, shows the current and proposed depreciation rates for Nuclear Production, by unit, that APS estimates would result from the Palo Verde license extension.

Paragraph 11.1 also provides that APS shall file a request that the Commission reduce the System Benefit Charge ("SBC") to reflect a corresponding reduction of the decommissioning trust funding obligations collected through the SBC related to the Palo Verde license extension.

As explained in paragraph 11.3, allowing APS to implement new, lower depreciation rates before the Company's base rates for electric service are reestablished in the Company's next rate case is intended to represent a benefit to APS. During that period, the lower recorded depreciation expense amounts mean that Accumulated Depreciation (a rate base offset) would be lower and APS' rate base in the next rate case would be higher.

As with the other aspects of the Settlement Agreement that involved compromises from Staff's normal litigation position on such issues, Staff witness Ernest Johnson is addressing the policy reasons for this treatment in the context of the Settlement Agreement.

INTRODUCTION

Q. Please state your name, position, and business address.

A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154.

Q. Are you the same Ralph C. Smith who previously submitted prefiled direct testimony on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff") that was filed on December 19, 2008 in this proceeding?

A. Yes.

Q. Have you prepared any exhibits to be filed with your testimony?

A. Yes. Attachment RCS-8 presents an update of Staff Schedule C-15 showing additional details for the adjustment to fuel and purchased power expense.

Q. What is the purpose of your testimony in support of the settlement?

A. The purpose of my testimony in support of the settlement is to explain the derivation of the base rate increase, some of the figures, and some of the other accounting treatments that are provided for in the Settlement. The base rate increase provided for in the Settlement is strictly for purposes of this Settlement and should not be viewed as necessarily representing positions that Staff would be advocating in any other situation. All of the Staff policy decisions related to the Settlement are addressed in the testimony of Staff witness Ernest Johnson.

DISCUSSSION OF SPECIFIC SETTLEMENT AGREEMENT PROVISIONS

Q. What aspects of the Settlement Agreement are addressed in your testimony?

A. My testimony addresses aspects of the following provisions of the Settlement Agreement:

- III. Rate Increase
- IV. Cost of Capital
- V. Depreciation
- VI. Fuel and Power Supply Adjustment Provisions
- VIII. Equity Infusions to Be Made by APS
- IX. Pension and OPEB Deferrals
- X. Treatment of Schedule 3
- XI. Adjustment of Depreciation Rates for Palo Verde License Extension

The numbering of these provisions in my testimony corresponds with the Settlement Agreement.

III. RATE INCREASE

Q. For Settlement purposes, to what amount of base rate increase did the signing parties agree?

A. For Settlement purposes, Staff, Arizona Public Service ("APS"), and a number of other parties to this rate case have agreed to a rate increase that would provide APS with approximately $344.7 million of base rate revenue per year. As shown in the Settlement Agreement, page 13, paragraph 3.8, this $344.7 million is approximately a 13 percent increase over APS's current revenue of $2.637 billion. In dollar terms, the base rate increase over APS's current revenue of $344.7 million is the sum of three components: (1) a non-fuel related base rate increase of approximately $196.3 million; (2) approximately $11.2 million for a fuel related increase in base rates; and (3) approximately $137.2 million for the adjusted base cost of fuel related increase. This is also addressed in paragraph 3.2 through 3.6 of the Settlement.

Q. What fair value rate base and fair value rate of return did the signing parties agree to for Settlement purposes?

A. As described in paragraph 3.5 of the Settlement, the parties agreed to an Arizona jurisdictional fair value rate base for the test year ending December 31, 2007, of approximately $7.666 billion. The Settlement Agreement at paragraph 4.3 provides for a 6.65 percent fair value rate of return ("FVROR") as shown on Settlement Attachment A.

Q. How does the amount of revenue increase provided for in the Settlement Agreement compare with what APS, Staff and other signatories had originally proposed?

A. A table shown on Settlement page 13, paragraph 3.8 (which is reproduced below for ease of reference) summarizes the base rate and total rate increase that APS, Staff, Residential Utility Consumer Office ("RUCO") and Arizonan for Electric Choice and Competition ("AECC") each had originally recommended, and shows the corresponding Settlement amounts:

Comparison of APS, Staff, RUCO and Settlement Summary of Base Rate Increase (Thousands of Dollars)	APS Proposed	Staff Proposed	RUCO Proposed	AECC Proposed	Settlement
Components of Total Rate Increase					
Base Rate Increase	$ 264,341	$ 155,062	$ (27,281)	$ 205,444	$ 196,300
Fuel Related Increase in Base Rates	$ 13,876	$ 11,436	$ 13,876	$ 10,695	$ 11,203
Total Base Rate Increase	$ 278,217	$ 166,498	$ (13,405)	$ 216,139	$ 207,503
Adjusted Base Cost of Fuel Related Increase	$ 169,977	$ 140,088	$ 169,977	$ 130,527	$ 137,235
Total Rate Increase Requested	$ 448,194	$ 306,586	$ 156,572	$ 346,666	$ 344,738
Percentage Increase Over Current Rates					
Revenue from Sales to Ultimate Retail Customers					
2007 Test Year Adjusted	$ 2,637,447	$ 2,637,447	$ 2,748,697	$ 2,637,447	$ 2,637,447
Percentage Increase - Net of PSA	10.55%	6.31%	-0.49%	8.20%	7.87%
Percentage Increase - Total	16.99%	11.62%	5.70%	13.14%	13.07%
Revenue from Sales to Ultimate Retail Customers					
2010 Base Rate Revenue per APS	$ 2,654,236	$ 2,654,236	$ 2,654,236	$ 2,654,236	$ 2,654,236
Percentage Increase - Net of PSA	10.48%	6.27%	-0.51%	8.14%	7.82%
Percentage Increase - Total	16.89%	11.55%	5.90%	13.06%	12.99%

The $344.7 million total rate increase provided for in the Settlement is below the amounts recommended in APS' and AECC's direct filings, and is above the amounts recommended in Staff's and RUCO's direct filings.

Q. Has a portion of the amount of base rate increase provided for in the Settlement already been implemented by APS?

A. Yes. A portion of the base rate increase had already been put into effect when the Commission granted APS an interim increase of $65.2 million in 2008.

Q. Referring to the above table, please explain briefly how the Settlement "base rate increase" amount of $196.3 million was derived.

A. The "base rate increase" of $196.3 million was arrived at through lengthy negotiations between the Signatories over the past 5-6 months. Staff witness Ernest Johnson's testimony in support of the Settlement explains the policy considerations involved. In dollar terms, the following presents a rough synopsis of the $196.3 million base rate revenue increase provided for in the Settlement, starting from the recommendation in Staff's direct testimony filing:

Approximate Derivation of the $196.3 Million
(Amounts in Millions)

Line No.	Description	Revenue Requirement Amount (Decrease) Increase	Reference
1	Staff base rate revenue increase	$ **155.1**	Attachment RCS-2, Sch A, p.2, Col.B, L.9
	Supplemental:		
2	Remove APS adjustment for DSM Lost Revenue aka Uncollected Fixed Costs	$ (15.7)	R Smith Supplemental Direct filed 1-9-2009
	Corrections:		
3	Yucca Units 5 & 6	$ 1.0	Settlement Negotiations
4	Income Tax Calculation/Interest Synchronization	$ 7.4	Settlement Negotiations
	Additions:		
5	Additional Post Test Year Plant	$ 48.6	Settlement Negotiations
6	**Base rate revenue increase per Settlement**	$ **196.3**	Settlement Negotiations (sum of Lines 1-5)*

*Numbers may not add exactly due to rounding.

Q. Please briefly explain the adjustment to remove the APS adjustment for DSM Lost Revenue also know as Uncollected Fixed Costs.

A. This adjustment was addressed in my supplemental testimony, filed on January 9, 2009. APS witness Ewen's Attachment PME-13 (filed with his direct testimony) and described in his direct testimony at page 33, shows that APS had proposed to reduce test year operating revenue by $16.789 million for 220,696 MWh of lost sales, and to reduce related operating expenses by $1.052 million, for a net reduction to pre-tax operating income of $15.738 million. In Docket No. E-01345A-05-0816 et al, APS had proposed a pro forma adjustment for estimated 2006 lost revenues from DSM programs in conjunction with a test year ended September 30, 2005, i.e., approximately 1.25 years beyond the test year. In the current case, APS has proposed a pro forma adjustment for estimated 2010 lost revenue from DSM programs in conjunction with a 2007 test year, i.e., three years beyond the test year. In Decision No. 69663, the Commission had rejected the similar adjustment proposed by APS in that rate case. As I had stated in my supplemental testimony (at page 3):

> The approximate impact from APS' proposed adjustment no. 13 to the revenue requirement is $15.7 million. ... Unless APS provides a compelling argument for this adjustment, including a strong argument why a conclusion different than Decision No. 69663 is required, Staff will reverse APS proposed adjustment no. 13 when Staff updates its revenue requirement model at the time of Staff's surrebuttal filing.

The Settlement Agreement revenue requirement reflects this reduction of $15.7 million to reverse APS' proposed adjustment for DSM lost revenues also known as Unrecovered Fixed Charges.

Q. Please briefly explain the correction items to Staff's direct-filed revenue requirement.

A. It was brought to my attention that there were two errors in the calculation of Staff's revenue requirement. The first item related to including in jurisdictional rate base the cost of a step-up transformer for Yucca Units 5 and 6 and reflected actual costs incurred for plant balances through 12/31/08 as opposed to 09/30/08 actual costs incurred. The second item related to a correction to Staff's interest synchronization calculation for the amount "per APS' filing"[1] to take into account the interest synchronization that was reflected by the Company in each individual pro forma adjustments on APS Schedule C-2. These two corrections to Staff's revenue requirement were accepted by Staff and the other Signatories in Settlement discussions, and were reflected in deriving the amount of base rate increase that is provided for in the Settlement.

---

[1] See, Attachment RCS-2, Schedule C-13, line 4, as filed with my direct testimony.

Q. Please briefly explain the adjustment for additional post test year plant.

A. The additional $48.6 million represents one way of deriving an adjustment to the revenue requirement to provide rate recognition for additional APS post-test year plant additions through June 30, 2009, i.e., for a period of 18 months beyond the 2007 test year. Staff witness Ernest Johnson's testimony in support of the settlement explains the reasons for why Staff agreed to including this for purposes of deriving the amount of revenue increase provided for in the Settlement.

Q. The next item in the Settlement Agreement, paragraph 3.8, in the "Settlement" column, is $11.203 million for a "Fuel Related Increase in Base Rates." Can you please briefly explain that item?

A. Yes. This item is comparable to the $11.436 million shown in the "Staff Proposed" column.[2] When the Company's Base Cost of Fuel is reestablished in a base rate case, this impacts the amounts that APS can recover through its Power Supply Adjustor ("PSA") mechanism, which has a 90/10 sharing provision.[3] The reestablishment of a higher Base Cost of Fuel in this case allows APS to recover in base rates approximately $11.203 million more than APS would have been able to recover in increased fuel and purchased power costs solely through the operation of the PSA.

Staff's adjustment for the Base Cost of Fuel was presented on Attachment RCS-2, Schedule C-15, filed with my direct testimony. In that adjustment, Staff had used a base cost of fuel of 3.7677 cents per kWh. The Settlement Agreement (at paragraph 6.2) provides for a slightly lower Base Cost of Fuel of 3.7571 cents per kWh. This difference in the Base Cost of Fuel is attributed to the decrease of approximately $233,000 from the

---

[2] This amount also appears on Attachment RCS-2 (to my direct testimony), Schedule A, page 1, line 9, and page 2, line 10.

[3] Per Settlement Agreement paragraph 6.1, the 90/10 sharing provision in the current PSA will be continued for purposes of the resolution of this rate case.

$11.436 million in Staff's direct filing to the $11.203 million provided for in the Settlement.

Q. Have you prepared an update to Staff Schedule C-15 that shows this?

A. Yes. Attachment RCS-8 to my testimony in support of the Settlement updates Staff Schedule C-15, and includes some additional calculation detail, showing the derivation of the $11.203 million Settlement amount and the $11.436 million amount from Staff's direct filing.

Q. *Please briefly* explain the "Adjusted Base Cost of Fuel Related Increase" of $137.235 million that appears in the Settlement Agreement, paragraph 3.8 table.

A. The $137.235 million represents the amount of fuel and purchased power cost increase that is now to be included in APS' base rates, at the Base Cost of Fuel of 3.7571 cents per kWh. Were it not for the base rate case, APS would have recovered this amount of fuel and purchased power cost increase through the operation of its PSA. The derivation of the $137.235 million is also shown on Attachment RCS-8.

Q. What average percentage increase in base rates does the revenue increase of $344.738 million represent?

A. As shown in the Settlement Agreement at paragraph 3.8, this represents an average increase of approximately 13.07 percent over the adjusted 2007 test year base rate revenue.

Q. Are there other provisions in the Settlement Agreement that would result in future rate increases to APS customers?

A. Yes. As described in the Settlement at paragraph 3.9, APS has various adjustor mechanisms, which are estimated to produce net additional rate increases. Staff witness Barbara Keene's testimony in support of the settlement addresses those mechanisms. Additionally, as described in the Settlement at paragraph 3.10, there are other provisions of the Settlement which do not have a rate impact in the present case, but will have an impact in future APS rate cases. I address some of those items in subsequent sections of my testimony in support of the Settlement.

IV. COST OF CAPITAL AND FAIR VALUE RATE OF RETURN

Q. Please refer to paragraphs 4.1 and 4.2 of the Settlement Agreement. What is the source for the capital structure and cost rates?

A. The source for the capital structure and cost rates specified in paragraphs 4.1 and 4.2 of the Settlement Agreement is the agreement of the Signatories. These amounts can also be found in Staff's direct filing at Attachment RCS-2, Schedule D, lines 5-8, and produce a weighted cost of capital of 8.58 percent.

The Settlement Agreement provides for a return on equity of 11.0 percent, which was the Staff recommendation. The 11.0 percent was at the high end of the range from 9.0 percent to 11.0 percent recommended by Staff witness David Parcell. Staff witness Ernest Johnson's direct testimony, at page 8, explained that Staff's use of the high end of Mr. Parcell's recommended range was intended to aid APS in its efforts to secure access to capital.

Q. Please refer to paragraph 4.3 of the Settlement Agreement. How was the 6.65 *percent calculated?*

A. The Settlement Agreement at paragraph 4.3 provides for a 6.65 percent fair value rate of return ("FVROR"), which is calculated as shown on Settlement Attachment A.

As explained on page 8 of Staff witness Johnson's direct testimony, as a policy decision in this case, Staff had proposed a revenue requirement for APS using a FVROR that recognized a 1.5 percent return to the difference between Fair Value Rate Base ("FVRB") and Original Cost Rate Base ("OCRB").

As shown on Attachment RCS-2 to my direct testimony, Schedule A, page 2, column B, line 8, applying this FVROR to the FVRB provided APS with a base rate increase of $51.265 million that was in addition to the OCRB-based calculation. This 1.5 percent return was also incorporated into the FVROR for Settlement Purposes, as shown on line 9, of Settlement Attachment A.

V. DEPRECIATION

Q. Please address the depreciation rates provided for in the Settlement Agreement at Section V.

A. Section V of the Settlement Agreement addresses depreciation rates. It provides that APS shall use the depreciation rates contained in Attachment REW-1 to APS witness Ronald White's direct testimony, with the exception of Account 370.01, Electronic Meters, for which APS will continue to use the existing depreciation rate of 3.68 percent. This treatment is consistent with the recommendations made concerning depreciation rates in the Staff direct filing.

VI. FUEL AND POWER SUPPLY ADJUSTMENT PROVISIONS

Q. Please address the Fuel and Power Supply Adjustment provisions provided for in the Settlement Agreement at Section VI.

A. Section VI of the Settlement Agreement addresses the provisions of the PSA that have been agreed to by the Signatories through the process of negotiation.

As provided for in Settlement paragraph 6.1, the 90/10 sharing provision in the current PSA will be continued.

The Base Cost of Fuel and Purchased Power is $0.037571 cents per kWh and shall be reflected in APS' base rates.

Gains on SO_2 allowances over or under the normalized jurisdictional test year amount reflected in base rates of $7.045 million shall be recovered or refunded through the PSA mechanism.

The PSA Plan of Administration will be amended to reflect the terms of the Agreement.

Q. How does the Base Cost of Fuel and Purchased Power of 3.7571 cents per kWh provided for in the Settlement at paragraph 6.2 compare with APS' and Staff's direct filings?

A. The 3.7571 cents per kWh provided for in the Settlement at paragraph 6.2 corresponds to the forward-looking PSA rate currently in effect for APS. It is lower than both the 3.8783 cents per kWh used by APS in its direct filing and the 3.7677 cents per kWh from Staff's direct filing. It thus reflects, at least in part, the lower cost of fuel that APS has been experiencing recently.

Paragraph 2.6 of the Settlement Agreement provides for the possibility of an accelerated PSA reset at the time new base rates are implemented if APS's fuel and purchased power costs result in a PSA over-collected balance at that time.

Q. Please explain the Settlement treatment of the Gain on Sale of SO_2 Allowances.

A. The Settlement Agreement at paragraph 6.3 provides that Gains on SO_2 Allowance sales over or under the normalized jurisdictional test year amount shall be recovered and/or refunded through the PSA mechanism.

Staff's derivation of the proposed revenue increase had reflected a normalized amount of Gains on the Sale of SO_2 Allowances of approximately $7.045 million as an offset to the test year expenses[4] (which in turn reduced the amount of the base rate revenue increase). Staff's recommendation was also that annual fluctuations above or below the amounts reflected in base rates for Gains on the Sale of SO_2 Allowances should be reflected as adjustments to PSA-includable costs. The Settlement provides for 100 percent of the annual Gains on the Sale of SO_2 Allowances to be credited in the PSA against PSA includable costs. Crediting such gains through the PSA is appropriate and reasonable because Gains on the Sale of SO_2 Emission Allowances are closely related to the amount of coal burned at APS's generating plants, can be significant in amount, and can fluctuate significantly from year to year.

VIII. EQUITY INFUSIONS INTO APS

Q. Please discuss the Settlement provisions for equity infusions into APS.

A. As provided in Settlement paragraph 8.1, APS agrees to complete equity infusions of at least $700 million during the period beginning June 1, 2009 through December 31, 2014.

[4] See Attachment RCS-2, Schedule C-14, Column B, line 1, as filed with my direct testimony.

This amount includes the "up to $400 million" previously authorized by the Commission in Decision No. 70454, which authorization expires on December 31, 2009.

Equity infusions are an important component of APS using its best efforts to maintain investment grade financial ratios and a balanced capital structure, and its efforts to improve its existing ratings with the financial rating agency community.

IX. PENSION AND OPEB DEFERRALS

Q. Please discuss the Settlement provisions for Pension and Other Post Employment Benefit ("OPEB") deferrals.

A. Section IX of the Settlement Agreement provides for limited deferrals of Pension and OPEB costs by APS in 2011 and 2012 if such costs exceed the test year level, which the Signatories to the Settlement Agreement have identified as $23.949 million.

Deferrals of Pension and OPEB costs that occur under such provisions of the Settlement would present an additional cost to APS' ratepayers in a future rate case. The total additional cost to ratepayers from this provision could be as much as $42.5 million (if the maximum deferrals in 2011 of $13.5 million and 2012 of $29 million occur).

The annual impact to APS ratepayers would depend upon the amortization period selected in a future APS next rate case. For illustrative purposes, if a five-year amortization period were to be used, and the deferrals reached the maximum amount of $42.5 million, the annual impact on APS ratepayers would be approximately $8.5 million of additional rate increase per year.[5] If a seven-year amortization period were to be used, the annual impact

[5] $42.5 million / 5 years

on APS ratepayers would be approximately $6.1 million of additional rate increase per year.[6]

Another witness for Staff, Ernest Johnson, is addressing the policy reasons for why Staff has agreed to provide APS with the deferred accounting treatment.

X. TREATMENT OF SCHEDULE 3

Q. How does APS currently account for Schedule 3 receipts?

A. Currently, APS records Schedule 3 receipts as Contributions in Aid of Construction ("CIAC").

Q. How is CIAC typically treated for ratemaking purposes?

A. CIAC is typically treated for ratemaking purposes as an offset to rate base. The rate base offset amount related to CIAC is typically based on the unamortized CIAC balance, less an income tax impact that is accounted for in the balance of Accumulated Deferred Income Taxes ("ADIT").

As a simplified example, if a utility had $100 million of unamortized CIAC (and there was a 40 percent combined state and federal income tax rate), rate base would be reduced by approximately $60 million ($100 million of CIAC less $40 million of ADIT).

The amortization of CIAC is typically reflected for ratemaking purposes as an offset to a utility's depreciation expense.

[6] $42.5 million / 7 years

Q. What amounts does APS expect for Schedule 3 receipts?

A. As stated in paragraph 10.2, APS estimated that its Schedule 3 revenues would be $23 million in 2010, $25 million in 2011 and $49 million in 2012.

Q. Does accounting for Schedule 3 receipts as revenue during this period have future rate consequences?

A. Yes. Recording Schedule 3 receipts as revenue, rather than as CIAC, will have consequences for APS' ratepayers in a future rate case. All other things being equal, rate base in a future APS rate case would be higher because of this treatment.

Q. Is it possible to estimate the increased rate base, post-2012, that would result from APS' accounting for Schedule 3 receipts as revenue during the period, 2010 through 2012?

A. Not reliably. The amounts identified by APS for 2010-2012 sum to $97 million. The rate base increase would be approximately the sum of the Schedule 3 amounts for 2010-2012 that APS accounted for as revenue, rather than as CIAC, less the related ADIT impact.

XI. ADJUSTMENT TO DEPRECIATION RATES FOR PALO VERDE LICENSE EXTENSION

Q. Has APS applied for a Palo Verde license extension?

A. Yes. APS has applied for a license extension for the Palo Verde nuclear generating plant.

Q. How would APS' depreciation rates be impacted by a Palo Verde license extension?

A. The cost of the plant is being depreciated over the remaining period of the license. With a license extension, the remaining cost of the plant would be depreciated over a significantly longer period, and the result would be significantly lower depreciation rates.

Q. Where are the anticipated new depreciation rates related to a Palo Verde life extension specified in the Settlement Agreement?

A. Attachment B to the Settlement Agreement, at pages 5-6, shows the current and proposed depreciation rates for Nuclear Production, by unit, that APS estimates would result from the Palo Verde license extension.

Q. Are the new depreciation rates related to a Palo Verde life extension significantly lower than the present Palo Verde depreciation rates?

A. Yes. Referring to Settlement Agreement Attachment B, for example, at page 5 of 8, APS' current depreciation rate for Palo Verde, on a composite basis, is 2.80 percent. With a license extension, the Palo Verde composite depreciation rate[7] would drop to 1.36 percent. In other words, the composite depreciation rate for Palo Verde in total would be cut by more than half, as a result of reflecting the impact of the license extension.

Q. How is the implementation of new depreciation rates by a utility typically coordinated with the ratemaking process?

A. Typically, the implementation of new depreciation rates is coordinated with the ratemaking process by having new depreciation rates be implemented at the same time that a utility's new base rates become effective.

Q. Why is that coordination of new depreciation rates in the ratemaking process usually considered important?

A. Depreciation expense is a significant component of a utility's cost of service. Coordinating the implementation of new depreciation rates, especially where the new rates represent significant changes from the existing rates, with changes in the utility's base

---

[7] As shown in the Settlement Agreement, Attachment B, APS does not apply depreciation rates for its generating units on a composite basis; rather, APS applies such depreciation rates by unit and by type of plant.

rates for utility service helps assure that the Depreciation Expense and Accumulated Depreciation that the utility records on its books is coordinated with the rates that ratepayers are paying for utility service. Accumulated Depreciation is a significant offset to a utility's rate base.

Q. How does the Settlement Agreement provide for the implementation by APS of new, significantly lower depreciation rates related to a Palo Verde life extension?

A. Section XI of the Settlement Agreement at paragraph 11.1 provides for APS to record lower depreciation expense on Palo Verde to reflect the impact of a license extension that APS anticipates. APS would implement the lower Palo Verde depreciation rates upon the later date of (1) receiving Nuclear Regulatory Commission ("NRC") approval for the Palo Verde license extension, or (2) January 1, 2012.

Q. How is this provision intended to benefit APS?

A. As explained in paragraph 11.3, allowing APS to implement new, lower depreciation rates before the Company's base rates for electric service are reestablished in the Company's next rate case is intended to represent a benefit to APS. APS' reported earnings would be improved by recording lower depreciation expense for some period before the lower depreciation expense is recognized in the establishment of customer rates for electric service.

Q. How could this provision in the Settlement result in higher future costs to APS' ratepayers?

A. It could result in a higher rate base from a lower amount of Accumulated Depreciation compared to a situation when the new depreciation rates were implemented at the same time as the utility's new base rates went into effect. Specifically, APS would be recording lower Palo Verde Depreciation Expense before lower recorded depreciation expense amounts are recognized in the ratemaking process. During that period, the amount of Accumulated Depreciation (a rate base offset) recorded by APS would be lower and, consequently, APS' rate base in a future rate case (or cases) would be higher than compared to a situation when the new depreciation rates were implemented at the same time as the utility's new base rates went into effect.

Q. When would APS ratepayers start to benefit from the lower Palo Verde depreciation expense?

A. Ratepayers would start to benefit from the lower Palo Verde depreciation expenses once APS' base rates were adjusted in a future rate case to reflect the impact of this reduced expense.

Q. Would a Palo Verde life extension affect any other expenses?

A. Yes. Other things being equal, a Palo Verde life extension would also be expected to significantly reduce APS' nuclear decommissioning expense.

Q. How does the Settlement Agreement provide for recognizing the impact of decreased decommissioning expense?

A. The Settlement Agreement at paragraph 11.1 provides that APS shall file a request that the Commission reduce the System Benefit Charge ("SBC") to reflect a corresponding reduction of the decommissioning trust funding obligations collected through the SBC related to the Palo Verde license extension. Moreover, it is the Signatories' intention that the reduction in decommissioning expense be passed onto APS' ratepayers, via a reduction to the SBC, concurrently with when APS begins to record the lower Palo Verde depreciation expense on its books.

Q. Does this conclude your Testimony?

A. Yes, it does.

Arizona Public Service Company
Base Fuel and Purchased Power

Test Year Ended December 31, 2007

Attachment RCS-8
Docket No. E-01345A-08-0172
Schedule C-15
Page 1 of 1
UPDATED FOR SETTLEMENT

Line No.	Description	Total Company Amount (A)	ACC Jurisdictional Amount (B)	Reference
1	Adjustment to Base Fuel and Purchased Power	$ (32,317,378)	$ (32,317,378)	A
1a	**PER SETTLEMENT**	**$ (35,425,907)**	**$ (35,425,907)**	
1b	Difference	$ (3,108,529)	$ (3,108,529)	

Notes and Source
A: Per APS Witness Ewen Attachment PME-3 and APS' supplemental response to Staff ___

Line	Description	Per APS	Per Staff	Adjustment
	Adjusted Test Year Fuel and Purchased Power Costs (cents per kWh)			
2	Normalized Fuel and Purchased Costs	3.8783	3.7677	
3	Test Year Fuel and Purchased Power Costs	3.4346	3.4346	
4	*Difference*	0.4437	0.3331	
	Adjusted Test Year Retail Sales (MWh)			
5	Test Year Retail Sales (MWh)	29,171,321,000	29,171,321,000	
6	Pro Forma Adjustment to Normalize Weather	(445,396,000)	(445,396,000)	
7	Pro Forma Adjustment to Annualize 12/31/07 Customer Level	494,127,000	494,127,000	
8	Adjusted Test Year Retail Sales	29,220,052,000	29,220,052,000	
9	Pro Forma Adjustment to Fuel and Purchased Power Expense	$ 129,649,371	$ 97,331,993	$ (32,317,378)

ESTIMATED IMPACT OF FUEL AND PURCHASED POWER ABOVE CURRENT BASE COST OF FUEL
IMPACT ON PSA REVENUE

Line	Description		Per Staff Direct Filing		($000)
10	Normalized Fuel and Purchased Costs	3.8783	**3.7677**		
11	Existing base fuel rate	3.2491	3.2491		
12	Increase above current base cost of fuel	0.6292	0.5186		
13	Increase in fuel cost above existing base fuel rate	$ 183,863,771	$ 151,535,190	$ (32,328,581)	$(32,329)
14	Related reduction in PSA revenue	$ 169,987,454	$ 140,098,732	$ (29,888,722)	$(29,889)
15	Increase in fuel cost that would not be subject to recovery in PSA	$ 13,876,317	$ 11,436,458	$ (2,439,859)	$ (2,440)
16	Rounded to thousands	$ 13,876	$ 11,436	$ (2,440)	

ESTIMATED IMPACT OF FUEL AND PURCHASED POWER ABOVE CURRENT BASE COST OF FUEL
IMPACT ON PSA REVENUE

Line	Description		PER SETTLEMENT		($000)
17	Related reduction in PSA revenue	169,987,454.0000	**3.7571**	**Per APS's PSA filing**	
18	Existing base fuel rate	3.2491	3.2491		
19	Increase above current base cost of fuel	169,987,450.7509	0.5080		
20	Increase in fuel cost above existing base fuel rate	$ 183,863,771	$ 148,437,864	$ (35,425,907)	$(35,426)
21	Related reduction in PSA revenue	$ 169,987,454	$ 137,235,163	$ (32,752,291)	$(32,752)
22	Increase in fuel cost that would not be subject to recovery in PSA	$ 13,876,317	$ 11,202,701	$ (2,673,616)	$ (2,674)
23	Rounded to thousands	$ 13,876	$ 11,203	$ (2,673)	
24	Difference from Staff direct filing		$ (233)	$ (233)	

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND RESONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	DOCKET NO. E-01345A-08-0172

DIRECT TESTIMONY

IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT

FRANK W. RADIGAN

ON BEHALF OF

THE ARIZONA CORPORATION COMMISSION,

UTILITIES DIVISION STAFF

JULY 01, 2009

TABLE OF CONTENTS

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Frank W. Radigan. I am a principal in the Hudson River Energy Group, a consulting firm providing services regarding the electric utility industry and specializing in the fields of rates, planning, and utility economics. My office address is 120 Washington Avenue, Albany, New York 12210.

Q. Are you the same Frank Radigan who previously filed testimony in this proceeding?

A. Yes. I previously filed direct testimony on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff").

Q. What is the scope of your testimony?

A. I will address the revenue allocation and rate design issues contained in the Settlement Agreement. The Settlement Agreement addresses revenue allocation and rate design in Sections XVII - XXI.

REVENUE ALLOCATION

Q. Please comment on the revenue allocation contained in the Settlement Agreement.

A. The Settlement Agreement at Section XVII provides that each retail rate schedule will receive an equal percentage total base rate increase, inclusive of the interim rate increase, and inclusive of fuel and purchased power costs that are incorporated into base rates. Existing low-income schedules, however, shall not receive any base rate increase, as set forth in Paragraph 16.1. The total base rate increase, is $344.7 million which results in a 13.07% increase.

In addition, the base rate increase allocated to the E-32 rate class is differentiated between the four subclasses within the service class. The subclasses are differentiated by customer size, and the revenue allocation to the larger customers is less than the revenue allocation to the smaller classes. The E-32 (400 + kW) subclass will receive an increase that is 2.5% below the average for the group. The next subclass of E-32 (101-400 kW) will receive the group average increase, and the next subclass of E-32 (21-100 kW) will receive an increase that is 1% above the average for the group. The last subclass, E-32 (0-20 kW), will receive an increase that is above the average for the group in order to recover the remaining revenue requirement (approximately 2.8%). This allocation among subclasses reflects of the expected differences in the cost to serve them.

There have been a considerable number of changes in rate classes in this and the Company's last rate case. In my direct testimony, I questioned whether the cost of service study properly captured all the impacts. The allocation in the Settlement Agreement is a reasonable resolution of the various proposals put forth by parties in their testimony.

RATE DESIGN

Q. Could you please comment on the rate design issues in the Settlement Agreement?

A. Yes, the Settlement Agreement at Section XVIII calls for three specific rate design matters. The first addresses the voltage discount for Schedule E-35, the rate schedule that is applicable to APS' largest customers. Under the terms of the Settlement Agreement (paragraph 18.1), the voltage discount for customers taking service at transmission voltage level will be equal to the current discount adjusted by the overall E-35 percentage increase. The current discount is a 28% discount from the demand rate assessed to primary service customers.

The second matter addresses APS' proposal for third party transmission charges for Rate Classes E-34 and E-35. In its original filing, the Company had proposed the addition of a provision to the E-34 and E-35 rate schedules to require customers to compensate the Company for the costs of additional third-party transmission service that is required solely to provide service to a specific customer or customers. (Delizio PFT, page 33). Freeport-McMoRan & Gold, Inc. and Arizonans for Electric Choice and Competition opposed the change in direct testimony, claiming that it was both unusual in a retail rate tariff and that it could lead to double recovery. Paragraph 18.2 specifically rejects this APS proposal.

The third rate design matter addressed in the Settlement Agreement is the rate increase for the Schedules E-34, E-35, and E-32 (401+ kW). In the Company's original filing, it had asked that these charges be increased to better reflect the cost of service. Paragraph 18.3 of the Settlement Agreement will implement the rate increase for Rates E-34, E-35, and E-32 (401+ kW) by adopting APS' proposed changes in the customer charges with an equal percentage increase in demand and energy charges.

The three rate design matters addressed in the Settlement are limited and specific to a small number of customers. They are also reasonable as they either maintain the existing rate design discounts between voltage levels or move toward the cost of service.

INTERRUPTIBLE RATES

Q. Could you please comment on the proposed interruptible rate schedules?

A. Yes, Section XIX of the Settlement Agreement states that, within 180 days of the Commission's approval of the Settlement Agreement, APS, after consultation with Staff and interested stakeholders, will file for Commission approval an interruptible rate for customers with loads over three megawatts. The interruptible rate will provide a credit to participating customers based on avoided capacity costs and the customer's commitment to interrupt. While still in the development stage, the interruptible rate may consist of two rate elements for a short-term customer (e.g., one year) and a long-term customer (e.g., up to five-years).

Demand reduction programs are a useful tool in managing peak demand, and the introduction of such an interruptible rate could greatly assist in this effort. Allowing both short-term and long-term commitment periods is particularly interesting. In my experience, many utilities are reluctant to count on interruptible load in the long-term as they are not sure that it will be available as a resource. As such, the longer time period could further assist the utility in managing its peak demand.

DEMAND RESPONSE

Q. Could you please comment on the demand response proposals contained in the Settlement Agreement?

A. Yes, Section XX of the Settlement Agreement contains several offerings which could influence the timing of customer energy usage. Paragraph 20.2 commits APS to provide prospective customers with clear and complete information about all the demand side management options. It also provides that APS shall market its demand response programs with its energy efficiency programs. There are three specific demand response programs.

First, paragraph 20.3 of the Settlement Agreement states that a new super peak time-of-use rate for residential customers should be adopted. Super peak time-of-use rates have a short but high cost usage charge to encourage customers to avoid using power during the highest usage periods. In return, they receive a discount for usage in the off-peak period.

I supported the super peak time-of-use rate in my original testimony in this proceeding. This is yet another means by which to alleviate load during the critical peak period. The Company's existing TOU rate options have been effective in encouraging customers to move load to off-peak periods. The Super Peak TOU option, which concentrates the financial incentive to a select few hours during the peak months, could prove an even more effective tool.

The second demand response program in the Settlement Agreement is addressed in Paragraph 20.4. It calls for a critical peak pricing rate, GPP-GS, to be implemented on a pilot basis. The Agreement provides that the Company will make a good faith effort to attain participation of at least 200 customers in this pilot program. This is another Company proposal that I supported in my original testimony as it is a positive step to control peak load, it is targeted to customers that can most likely shed load; it provides an adequate discount to encourage participation, and it is limited in scope so that it can be controlled, evaluated, and improved before it is offered to all customers.

The third and last demand response program addressed in the Settlement Agreement is discussed in Paragraph 20.5. It calls for APS to implement a residential critical peak pricing pilot program but also to make a good faith effort to attain participation of at least 300 customers. As stated in the Settlement Agreement, this program will be designed to provide participating customers with strong, clear price signals that are narrowly focused on a limited number of specific hours of each year. Again, my examination of the Company's current time-of-use options shows that its customers react positively to price signals, this program could therefore be another valuable tool available to the Company.

Another positive aspect of the Settlement Agreement appears in Paragraph 20.6, where APS commits to prepare a study on the impact of its super peak and critical peak pricing programs on generation use, air emissions, and energy use. The study shall identify methods to better integrate demand response programs and energy efficiency programs. This is an important provision. Too many times programs are funded, but then uncoordinated with other efforts, and synergies are lost. Moreover, the commitment to learn and improve from pilot programs is important since I have too often seen such programs become orphaned after the initial effort.

OTHER RATE SCHEDULES

Q. Could you please comment on the other rate schedule matters?

A. The Settlement Agreement at Section XXI states, that within 90 days of approval of the Settlement Agreement, the Company will file a new optional TOU rate applicable to schools, K-12, which will be designed to provide daily and seasonal price signals to encourage load reductions during peak periods. The Arizona School Boards Association and the Arizona Association of School Business Officials sponsored testimony on the need for such a rate, and noted that Arizona School Districts will be facing major financial issues over the next several years. (Pre-Filed Testimony of Chuck Essigs, page 2). While many of the rate design matters in the Settlement Agreement are innovative and promising, this provision may well be the most interesting. This provision is a means to address the financial issues that school districts face. One must also recognize, that energy conservation results primarily from a knowledge of consumption and pricing however. Introducing these concepts into schools may be the best way to educate students, teachers, and parents of the benefits of energy conservation.

Q. Does this conclude your testimony?

A. Yes, it does.